BEFORE THE STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES
OFFICE OF ADMINISTRATIVE LAW

I/M/O THE PETITION OF UNITED WATER NEW JERSEY INC. FOR APPROVAL OF AN INCREASE IN RATES FOR WATER SERVICE AND OTHER TARIFF CHANGES	)))))	**BPU DKT. NO. WR09120987** **OAL DKT. NO. PUCRL 01200-2010N**

DIRECT TESTIMONY OF ROBERT J. HENKES ON BEHALF OF THE NEW JERSEY DEPARTMENT OF THE PUBLIC ADVOCATE DIVISION OF RATE COUNSEL

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UNITED WATER NEW JERSEY
BPU Docket No. WR09120987
Direct Testimony of Robert J. Henkes

TABLE OF CONTENTS

		Page
I.	**STATEMENT OF QUALIFICATIONS**	1
II.	**SCOPE AND PURPOSE OF TESTIMONY**	3
III.	**SUMMARY OF FINDINGS AND CONCLUSIONS**	5
IV.	**REVENUE REQUIREMENT ISSUES**	7
	A. TEST YEAR AND PRO FORMA YEAR	7
	B. RATE BASE	9
	- Utility Plant in Service	10
	- Accumulated Depreciation Reserve	13
	- Contributions in Aid of Construction	13
	- Customer Advances	14
	- Accumulated Deferred Income Taxes	14
	- Materials and Supplies and Prepayments	14
	- Cash Working Capital	15
	- Customer Deposits	18
	- Unamortized Debt Expense	18
	- Net Injury and Damage Reserve Balance	19
	- Consolidated Income Tax Benefits	20
	C. OPERATING INCOME	25
	- Metered Sales Revenues	26
	- Public and Private Fire Revenues	27
	- Labor Expenses	27
	- Purchased Water Expenses	32
	- Purchased Power Expenses	32
	- Chemical Expenses	33
	- Waste Residual Expenses	33
	- Tank Painting Expenses	34
	- Transportation Expenses	36
	- Uncollectible Expenses	37
	- Outside Services Expenses	37
	- Property and Liability Insurance	38
	- Injury and Damages Expenses	38
	- Employee Pensions and Benefits	39
	- Regulatory Commission Expenses	45
	- Management & Services Fees	47
	- Fringe Benefit/G&A Expense Transfers	50

Page

- Other O&M Expenses ………………………………………………… 50
- Miscellaneous Expense Adjustments ……………………………….. 51
- Expense Decrease Associated With Revenue Adjustment ……………. 52
- MTBE Amortization ………………………………………………….. 53
- Depreciation Expenses ………………………………………………. 53
- Revenue Taxes…………………………………………………………. 53
- Property Taxes ……………………………………………………….. 54
- Payroll Taxes ………………………………………………………….. 54
- Income Taxes …………………………………………………………. 54

D. PENSION/OPEB EXPENSE DEFERRAL MECHANISM ………… 55

E. DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (DSIC)….. 64

F. ENERGY AND CHEMICAL COST ADJUSTMENT CLAUSE ……. 70

APPENDIX I: Prior Regulatory Experience of Robert J. Henkes

SUPPORTING SCHEDULES RJH-1 THROUGH RJH-24

I. STATEMENT OF QUALIFICATIONS

Q. WOULD YOU STATE YOUR NAME AND ADDRESS?

A. My name is Robert J. Henkes and my business address is 7 Sunset Road, Old Greenwich, Connecticut 06870.

Q. WHAT IS YOUR PRESENT OCCUPATION?

A. I am Principal and founder of Henkes Consulting, a financial consulting firm that specializes in utility regulation.

Q. WHAT IS YOUR REGULATORY EXPERIENCE?

A. I have prepared and presented numerous testimonies in rate proceedings involving electric, gas, telephone, water and wastewater companies in jurisdictions nationwide including Arkansas, Delaware, District of Columbia, Georgia, Kentucky, Maryland, New Jersey, New Mexico, Pennsylvania, Vermont, the U.S. Virgin Islands and before the Federal Energy Regulatory Commission. A complete listing of jurisdictions and rate proceedings in which I have been involved is provided in Appendix I attached to this testimony.

Q. WHAT OTHER PROFESSIONAL EXPERIENCE HAVE YOU HAD?

A. Prior to founding Henkes Consulting in 1999, I was a Principal of The Georgetown Consulting Group, Inc. for over 20 years. At Georgetown Consulting I performed the same type of consulting services as I am currently rendering through Henkes Consulting. Prior to my association with Georgetown Consulting, I was employed by the American Can

Company as Manager of Financial Controls. Before joining the American Can Company, I was employed by the management consulting division of Touche Ross & Company (now Deloitte & Touche) for over six years. At Touche Ross, my experience, in addition to regulatory work, included numerous projects in a wide variety of industries and financial disciplines such as cash flow projections, bonding feasibility, capital and profit forecasting, and the design and implementation of accounting and budgetary reporting and control systems.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I hold a Bachelor degree in Management Science received from the Netherlands School of Business, The Netherlands in 1966; a Bachelor of Arts degree received from the University of Puget Sound, Tacoma, Washington in 1971; and an MBA degree in Finance received from Michigan State University, East Lansing, Michigan in 1973. I have also completed the CPA program of the New York University Graduate School of Business.

II. SCOPE AND PURPOSE OF TESTIMONY

Q. WHAT IS THE SCOPE AND PURPOSE OF THIS TESTIMONY?

A. I was engaged by the New Jersey Division of Rate Counsel ("Rate Counsel") to conduct a review and analysis and present testimony in the matter of the petition of United Water New Jersey Inc. for an increase in rates for water service and other tariff changes.

The purpose of this testimony is to present to the New Jersey Board of Public Utilities ("BPU" or "the Board") the appropriate rate base and pro forma test period operating income, as well as the appropriate revenue requirement for the Company in this proceeding. I am also presenting Rate Counsel's recommended position regarding the Company's requests for the implementation of a Pension/OPEB Expense Deferral Mechanism, a Distribution System Improvement Charge (DSIC) and an Energy and Chemical Cost Adjustment mechanism (ECCA).

In the determination of the Company's appropriate revenue requirement, I have relied on and incorporated the recommendations of the following Rate Counsel witnesses:

- Matthew Kahal, concerning the appropriate capital structure, capital cost rates and overall rate of return;
- Howard Woods, regarding post-test year plant additions and chemical expenses; and
- Mitchell Serota, regarding pension expenses.

In developing this testimony, I have reviewed and analyzed the Company's December 9, 2009 filing; supporting testimonies, exhibits and "SIR" workpapers; the Company's responses to initial and follow-up data requests by Rate Counsel and BPU Staff; and other relevant financial documents and data.

III. SUMMARY OF FINDINGS AND CONCLUSIONS

Q. PLEASE SUMMARIZE YOUR FINDINGS AND CONCLUSIONS IN THIS CASE.

A. I have reached the following findings and conclusions in this docket:

1. The appropriate rate base amounts to $539,893,198, which is $103,678,056 lower than the Company's proposed rate base of $643,571,254. Schedule RJH-1, line 1 and Schedule RJH-3.
2. The appropriate operating income amounts to $39,094,241, which is $4,619,435 higher than the Company's proposed operating income of $34,474,806. Schedule RJH-1, line 4 and Schedule RJH-9.
3. The appropriate overall rate of return for the Company, as recommended by Rate Counsel witness Matthew Kahal, is 7.35%, incorporating a recommended return on equity of 10.00%. This compares to the Company's proposed overall rate of return of approximately 8.62%, including a requested return on equity rate of 11.15%. Schedule RJH-1, line 2 and Schedule RJH-2.
4. The appropriate Revenue Conversion Factor to be used for ratemaking purposes in this case is 1.8008305. Both UWNJ and Rate Counsel have used this Factor. Schedule RJH-1, line 6.
5. The recommended ratemaking components outlined above indicate the need for a rate increase of $1,043,985, which is $36,775,321 lower than the Company's proposed rate increase of $37,819,306. Schedule RJH-1, line 7.
6. The recommended rate increase of $1,043,985 represents an increase of 0.6% in

the pro forma year operating revenues at current rates. By comparison, the Company's proposed rate increase of $37,819,306 represents a rate increase of 21.3%.

7. UWNJ's proposed Pension/OPEB Deferral mechanism, DSIC rate mechanism, and ECCA rate mechanism should be rejected by the Board as each of these proposed rate mechanisms:

   a) Represents inappropriate single-issue ratemaking;
   b) Is in violation of accepted ratemaking principles and inconsistent with appropriate regulatory policy;
   c) Represents a request for extraordinary remedy that is not needed and is unsubstantiated;
   d) Reduces the Company's incentive to manage its pension/OPEB plans, infrastructure replacement program, and purchased energy/chemical programs in the most efficient manner and at the lowest possible cost;
   e) Primarily benefits UWNJ's shareholders and inappropriately shifts virtually all risks from the shareholders to the ratepayers.

IV. REVENUE REQUIREMENT ISSUES

A. TEST YEAR AND PRO FORMA YEAR

Q. PLEASE DESCRIBE THE TEST YEAR AND PRO FORMA YEAR USED BY THE COMPANY TO SUPPORT ITS REQUESTED RATE INCREASE IN THIS PROCEEDING.

A. The Company's proposed Test Year and Pro Forma Year in this case are the twelve-month periods ending January 31, 2010 and July 31, 2010, respectively. The Company's filing data are based on 5 months of actual and 7 months of projected results for the Test Year; and 12 months of projected results for the Pro Forma Year. At the time this testimony was prepared, actual data for the full test year had become available for all operating income, rate base and capitalization components by way of numerous discovery requests.

The Company's proposed revenue requirement in this case is based on projected rate base balances as of the end of the Pro Forma Year, 7/31/2010. To be consistent with this post-test year rate base approach, the Company also annualized its revenues based on projected billing determinants as of 7/31/2010 and reflected depreciation expenses based on the projected 7/31/2010 depreciable plant balances. The Company's proposed operation and maintenance ("O&M") expenses and operating taxes are either based on the 2010 operating budget or reflect pro forma adjusted Test Year O&M expenses and taxes.

Q. DO YOU BELIEVE THAT THIS PROPOSED TEST YEAR AND POST-TEST

YEAR RATE MAKING APPROACH IS REASONABLE FOR PURPOSES OF DETERMINING UWNJ'S REVENUE REQUIREMENT IN THIS CASE?

A. Not entirely. While I agree with the use of the proposed 1/31/2010 Test Year, I do not agree with UWNJ's proposal to use projected Pro Forma Year rate base balances as of 7/31/2010 for routine, recurring projects, together with annualized depreciation expenses based on these projected 7/31/2010 plant balances and annualized revenues based on the projected 7/31/2010 billing determinants. I will discuss my disagreement on this point in more detail later in this testimony.

Q. COULD YOU EXPLAIN THE DIFFERENCES AND SIMILARITIES BETWEEN YOUR RECOMMENDED APPROACH AND THE COMPANY'S PROPOSED RATEMAKING APPROACH IN THIS CASE?

A. Yes. For reasons to be described in the next section of this testimony, I recommend that the pro forma plant in service balance in rate base be based on the actual balance at the end of the test year, 1/31/2010, plus projected net plant additions for major plant projects from 1/31/2010 through the end of the Pro Forma Year, 7/31/2010. Thus, my recommended plant in service balance excludes the Company's proposed routine, ongoing construction projects from the end of the Test Year to the end of the Pro Forma Year. Consistent with this recommended plant in service approach, I also reflected the annualized depreciation reserve as of the end of the test year. All of the recommended remaining rate base components other than working capital, materials and supplies and prepayments, I&D reserve balance and Consolidated Income Tax Benefits are based on the actual balances as of the end of the Test Year. The working capital balance is based on the Company's proposed lead-lag study, as adjusted by me; the recommended materials & supplies and prepayment, as well as I&D reserve rate base components represent the 13-month average balances for the Test Year; and the consolidated income tax benefit rate base deduction is based on a calculation methodology that will be discussed later on in this testimony.

Since my recommended plant in service excludes the projected routine, ongoing plant additions for the 6-month post-test year period 1/31/2010 – 7/31/2010, I have conservatively chosen to base my recommended pro forma annualized operating revenues on the annualized and normalized billing determinants as of the end of the Test Year rather than as of the end of the Pro Forma Year. The recommended depreciation expenses are based on the application of the Company's current depreciation rates to my recommended end-of-Test Year depreciable plant balances plus the annualized depreciation on the recommended post-Test Year major plant additions. Almost all of the recommended pro forma operating expenses and taxes have the Company's proposed pro forma annualized expenses and taxes as their starting point.

B. RATE BASE

Q. PLEASE SUMMARIZE THE COMPANY'S PROPOSED PRO FORMA RATE BASE AND THE RECOMMENDED RATE BASE ADJUSTMENTS MADE BY YOU.

A. The Company's proposed pro forma rate base of $643,571,253 is summarized by specific rate base component on Schedule RJH-3. As previously discussed, all of the Company's proposed pro forma rate base balances except those for materials & supplies, prepayments and cash working capital represent projected balances as of April 30, 2009. The proposed rate base balances for materials & supplies and prepayments represent the 13-month average balances for the 12-month period ended June 30, 2008 and the cash working capital requirement is based on a lead-lag study.

As shown on Schedule RJH-3, I recommend that numerous adjustments be made to the Company's proposed pro forma rate base, resulting in a recommended rate base balance of $539,893,198. Each of the recommended rate base adjustments will be discussed in detail below.

- <u>Utility Plant in Service</u>

Q. PLEASE DESCRIBE THE DERIVATION OF THE COMPANY'S PROPOSED PRO FORMA TEST PERIOD PLANT IN SERVICE RATE BASE BALANCE.

A. The Company is proposing a plant in service balance projected for 7/31/2010, the end of the Pro Forma Year. As shown on Exhibit P-4, Schedule 8, the Company projected the 1/31/2010 end-of-Test Year balance to be $886,690,137. The Company then added projected net plant additions of $51,583,315 for the period 2/1/2010 – 7/31/2010 to arrive at its proposed projected 7/31/2010 plant balance of $938,273,452.

Q. WHAT UTILITY PLANT IN SERVICE BALANCE DO YOU RECOMMEND TO BE USED FOR RATEMAKING PURPOSES IN THIS CASE?

A. As shown on Schedule RJH-4, I recommend a plant in service balance of $896,267,640. This recommended balance consists of the actual 1/31/2010 end-of-Test Year plant balance of $889,971,140 plus projected post-Test Year plant additions totaling $6,191,600 that were deemed to be "major in nature and consequence" by Rate Counsel witness Howard Woods. As shown on Schedule RJH-4, lines 2 and 3, these post-Test Year projects consist of the remaining post-Test Year Haworth project investments and some other major project investments.

Q. WHAT IS THE BASIS FOR THIS RECOMMENDED PLANT IN SERVICE BALANCE?

A. In *In Re Elizabethtown Water Co*., BPU Docket No. WR8504330, Order dated 5/23/85, the Board established the general policy that, in order for projected post-Test Year plant additions to be recognized for ratemaking purposes, the projected plant additions must be "major in nature and consequence." This general policy has been applied by the Board in all rate proceedings after BPU Docket No. WR8504330. For example, as discussed on pages 4 – 7 of the Board's Order in a prior Middlesex Water Company rate case, BPU Docket No. WR00060362, Middlesex had proposed rate recognition for projected post-test year plant additions totaling $3,816,558. *I/M/O Middlesex Water Co. For Approval of An Increase in Its Rates For Water Service and Other Tariff Changes*, BPU Docket No. WR00060362, Order dated 6/6/01. The BPU Staff determined in that case that $1,949,398 out of the total projected post-test year additions of $3,816,558 represented non-major *routine* construction projects. The Board's Order stated in this respect:

> With respect to the proposed routine capital budget items, amounting to $1,949,398, Staff was not persuaded that such expenditures, which the Company classified as routine, met the "major in nature and consequence" standard as set by the Board.
> *Id.* at 7.

The Board's Order goes on to state with regard to this issue:

> The ALJ also agreed with Staff's recommendation to reject the inclusion of $1,949,398 of proposed capital budget items, contending that these items are in fact routine, ongoing plant additions, and do not meet the "major in nature and consequence" test set by the Board.
> *Id.*

The Board adopted the above-referenced ALJ recommendation with regard to this post-test year plant addition issue.

Additionally, in the fully litigated Parkway Water Company rate case, Docket No. WR05070634, Parkway had requested rate recognition of projected post-test year plant additions. In rejecting these proposed post-test year plant additions, the Board stated on page 12 of its Order in that case:

> The post-test year additions of the type and extent proposed by the Company are common and routine in nature and consequence. Furthermore, the Company has not provided any supporting credible documentation to ascertain or confirm the in-service dates or the costs for these plant additions, and absent such critical information these additions must be disallowed.

In the case at hand, Rate Counsel witness Howard Woods, based on his review of UWNJ's proposed post-Test Year plant additions, has recommended that only the post-Test Year Haworth Plant Upgrade investment of $5,305,200 and certain additional investments of $886,400 meet the Board's Elizabethtown Water Company test. I have adopted Mr. Woods' recommendations.

- <u>Accumulated Depreciation Reserve</u>

Q. PLEASE EXPLAIN THE DERIVATION OF YOUR RECOMMENDED ACCUMULATED DEPRECIATION RESERVE BALANCE SHOWN ON SCHEDULE RJH-5.

A. I started out with the Company's actual accumulated depreciation reserve balance at 1/31/2010, the end of the Test Year. I then added the difference between my recommended annualized depreciation expenses in this case and the per books Test Year depreciation expenses (which are embedded in the Test Year-end depreciation reserve balance). The resulting recommended depreciation reserve balance amounts to $182,330,934.

In its response to RCR-A-140, the Company confirmed that there are no post-Test Year depreciation reserve retirements and costs of removal associated with the Haworth project and the other major projects recognized by Rate Counsel in post-Test Year plant in service in this case.

- <u>Contributions in Aid of Construction</u>

Q. PLEASE EXPLAIN THE DERIVATION OF YOUR RECOMMENDED CONTRIBUTION IN AID OF CONSTRUCTION ("CIAC") BALANCE SHOWN ON SCHEDULE RJH-3, LINE 3.

A. As shown in footnote (2) of Schedule RJH-3, my recommended CIAC balance consists of the actual 1/31/2010 Test Year-end balance of $33,211,859.

- **Customer Advances**

Q. PLEASE EXPLAIN THE DERIVATION OF YOUR RECOMMENDED CUSTOMER ADVANCES BALANCE SHOWN ON SCHEDULE RJH-3, LINE 4.

A. This recommended rate base balance represents the actual balance at the end of the Test Year, 1/31/2010.

- **Accumulated Deferred Income Taxes**

Q. PLEASE EXPLAIN THE DERIVATION OF YOUR RECOMMENDED ACCUMULATED DEFERRED INCOME TAX (ADIT) BALANCE SHOWN ON SCHEDULE RJH-3, LINE 5.

A. This recommended rate base balance represents the actual ADIT balance at the end of the Test Year, 1/31/2010 including the ADIT associated with AFUDC Equity which the Company has conceded should be part of the ADIT rate base deduction.[1]

- **Materials and Supplies and Prepayments**

Q. PLEASE EXPLAIN THE DERIVATION OF YOUR RECOMMENDED

1 See response to RCR-A-17.

MATERIALS AND SUPPLIES AND PREPAYMENT BALANCES SHOWN ON SCHEDULE RJH-3, LINES 6 AND 7?

A. These recommended rate base balances represent the actual 13-month average balances for the Test Year ending 1/31/2010.

- **Cash Working Capital**

Q. HOW DID THE COMPANY DETERMINE ITS CLAIMED CASH WORKING CAPITAL REQUIREMENT IN THIS CASE?

A. The Company determined its proposed cash working capital requirement based on a detailed lead-lag study. The detailed components and calculations underlying the Company's requested cash working capital requirement are summarized on Exhibit P-7. The Company has only considered in the lead-lag study expenses and taxes for which actual cash outlays are required during the study period and has excluded from the study such non-cash items as depreciation and amortization expenses and deferred taxes. The Company's lead-lag study also excludes any claimed cash working capital requirement for net income.

Q. DO YOU AGREE WITH THE COMPANY'S LEAD-LAG STUDY CALCULATIONS AND THE RESULTING PROPOSED CASH WORKING CAPITAL REQUIREMENT?

A. I agree with the Company that a properly conducted lead-lag study should *exclude* non-cash depreciation/amortization expenses and deferred income taxes and the return on equity. These items simply do not have a cash working capital requirement during the lead-lag study period. However, I also believe that the lead-lag study should *include* the appropriate cash working capital source produced by the long-term debt interest payment lag.

Interest expenses for long-term debt are included as part of the Company's revenue requirement. Therefore, the rates paid by UWNJ's customers are set so as to produce, in addition to other amounts, the sums necessary to pay interest to bondholders. As utility services are used, the Company receives money from its ratepayers that partly serves to enable the Company to pay interest to its bondholders. However, the Company does not have to pay its bondholders interest immediately. It only pays interest to its bondholders twice a year. Thus, while long-term interest expense accrues on a daily basis, it is paid out semi-annually in a lump sum. This means that, on average, interest on long-term debt has a payment lag of 91.25 days (365/4). Stated differently, this means that the Company, from the moment it receives the revenues to cover its long-term debt interest expenses until the time it actually pays out the interest expenses to its bondholders, has such funds available for general working capital purposes. For short term debt interest expenses, I have assumed an average payment lag of 15 days based on my assumption that the Company pays its short term debt interest on a monthly basis.

Q. SHOULD THE AVAILABILITY OF FUNDS DUE TO THIS INTEREST PAYMENT LAG BE CONSIDERED IN THE DETERMINATION OF THE COMPANY'S WORKING CAPITAL REQUIREMENT?

A. Yes. The interest payments to be made to the bondholders are fixed by contract. They cannot be made earlier or later than the specified date. In this, the bondholders are like the tax collector or any other creditor of the Company. To refuse to consider the source of working capital from the interest payment lag has the impact of penalizing the ratepayers who are providing revenues to pay all expenses, including interest expenses; and it would provide a "windfall return" to the Company's stockholders. The bondholder, who has a fixed interest on his bond, will not receive any benefits from the act of excluding the interest payment lag from working capital considerations. It will be the common stockholder who will be allowed to earn a return on such available funds, collected from the ratepayer through rates, if this interest payment lag is not recognized for rate making purposes. For all of these reasons, debt interest expenses should be included with the appropriate payment lag in the lead/lag study to determine the Company's cash working capital requirement.

Q. DO YOU RECOMMEND THAT OTHER ADJUSTMENTS BE MADE TO THE COMPANY'S PROPOSED CASH WORKING CAPITAL REQUIREMENT?

A. Yes. The Company's proposed cash working capital requirement includes the cash working capital impact of the revenue and income taxes associated with its proposed rate increase of $37,819,306. Based on the responses to RCR-A-24(e) and (f), I have calculated that this cash working capital impact amounts to $1,571,843.[2] As shown on Schedule RJH-7, lines 2 and 3, I have removed this Company-proposed cash working capital impact of $1,571,843 and, instead, have reflected a $0 cash working capital impact based on Rate

[2] For calculations, see Schedule RJH-7, footnote (1).

Counsel's recommended rate *decrease* in this case.

In addition, I have reflected two adjustments to correct for errors in the Company's cash working capital lead/lag study calculations. These required corrections, which were conceded by UWNJ in its responses to RCR-A-24 (b) and (c) and are shown on Schedule RJH-7, lines 4 and 5, concerned the removal from the cash working capital calculations of capitalized health insurance costs and payroll taxes.

Q. WHAT IS THE RECOMMENDED CASH WORKING CAPITAL AMOUNT AFTER REFLECTING THE PREVIOUSLY DISCUSSED ADJUSTMENTS?

A. As shown on Schedule RJH-7, the recommended cash working capital amount after reflecting the previously discussed adjustments is $13,021,183.

- **Customer Deposits**

Q. PLEASE EXPLAIN THE DERIVATION OF YOUR RECOMMENDED CUSTOMER DEPOSIT BALANCE SHOWN ON SCHEDULE RJH-3, LINE 9.

A. This recommended rate base balance represents the actual balance at the end of the Test Year, 1/31/2010.

- **Unamortized Debt Expense**

Q. PLEASE EXPLAIN THE DERIVATION OF YOUR RECOMMENDED

UNAMORTIZED DEBT BALANCE SHOWN ON SCHEDULE RJH-3, LINE 10.

A. This recommended rate base balance represents the actual balance, net of associated accumulated deferred income taxes, at the end of the Test Year, 1/31/2010. The calculations for this net balance are shown on Schedule RJH-3, footnote (5).

- **<u>Net Injury and Damages Reserve Balance</u>**

Q. PLEASE EXPLAIN THE RECOMMENDED RATE BASE BALANCE FOR THE INJURIES & DAMAGES ("I&D") RESERVE ACCOUNT SHOWN ON SCHEDULE RJH-3, LINE 11.

A. As shown in the response to RCR-A-21, the Company carries an I&D reserve balance on its books on a continuous basis. For the test year, the 13-month average I&D reserve balance amounted to $1,969,151. In the same data response, the Company also confirms that this I&D reserve balance consists of the accumulation of prior I&D expense accruals that have always been (and still are) charged as above-the-line operating expenses for ratemaking purposes. Therefore, the Company's I&D reserve balance represents zero cost, ratepayer-provided funds that are available to the Company in the operation of its business. Similar to other non-investor supplied funds such as customer deposits, customer advances, *etc*., this reserve balance should be treated as a rate base deduction. As shown in footnote (6) of Schedule RJH-3, after reflecting the offsetting accumulated deferred income taxes associated with this reserve balance, the net I&D reserve rate base deduction should amount to $1,279,948.

- **Consolidated Income Tax Benefits**

Q. HAS UWNJ REFLECTED ANY CONSOLIDATED INCOME TAX BENEFITS FOR RATEMAKING PURPOSES IN THIS CASE?

A. No. In this case, the Company has assumed that it pays income taxes on the so-called stand-alone basis. However, in reality, the Company does not calculate and pay income taxes on a stand-alone basis; rather it participates in consolidated income tax filings made by its parent company. In fact, for the tax years prior to 1994, UWNJ participated in the consolidated income tax filings of GWC & Subsidiaries; from 1994 through 2000, UWNJ was part of the United Water Resources consolidated tax filings; and from the year 2000 forward, UWNJ has been a member of the consolidated tax filings of Suez Environnement North America Inc.

Q. WHY DOES A CONSOLIDATED INCOME TAX FILING GENERATE TAX SAVINGS?

A. The primary purpose of consolidated income tax filings is to minimize the federal income tax liabilities of the participating members. Certain members of the consolidated income tax filing generate tax losses. These tax losses are used to offset a portion of the taxable income generated by other affiliates, including UWNJ, to reduce income taxes payable for the entire consolidated entity. Without a consolidated tax filing, it could take several years under the IRS's carry-forward and carry-back restrictions, if ever, before the recurring loss companies would be able to fully realize tax savings. By filing a consolidated return, however, the consolidated entity as a whole is able to realize, in the current tax year, the tax benefits generated by the loss companies.

Q. SHOULD UWNJ'S RATEPAYERS SHARE IN THE TAX SAVINGS REALIZED FROM THE CONSOLIDATED INCOME TAX FILINGS?

A. Yes. UWNJ's ratepayers should only reimburse the Company for actual income taxes paid. If the tax savings from the consolidated income tax filings are not flowed through to the UWTR ratepayers on an appropriate, proportionate basis, the ratepayers will pay rates that are higher than necessary to compensate UWNJ for its actual costs. I therefore recommend that an appropriate consolidated income tax benefit be calculated for UWNJ and reflected for ratemaking purposes in this case.

Q. DOES THE BOARD HAVE A RATE MAKING POLICY WITH REGARD TO THE RATE MAKING TREATMENT OF TAX BENEFITS TO BE ASSIGNED TO REGULATED UTILITIES UNDER ITS JURISDICTION AS A RESULT OF THESE UTILITIES' FILING OF CONSOLIDATED INCOME TAX RETURNS?

A. Yes. The Board has an established policy requiring that any tax savings allocable to a utility as a result of the filing of consolidated income tax returns be reflected as a rate base deduction in the utility's base rate filings. The BPU first established this policy in its Decision and Order in the Atlantic City Electric Company rate proceeding, BPU Docket No. ER90091090J. In this Order, the Board also ruled that the calculation starting point for the consolidated income tax related rate base deduction must be July 1, 1990:

> ...it is our judgment that the appropriate consolidated tax adjustment in this proceeding is to reflect as a rate base deduction the total of the 1991 consolidated tax savings benefits, and one-half of the tax benefits

> realized from AEI's 1990 consolidated tax filing...This finding reflects a balancing of the interests to reflect the unique period of uncertainty during the period 1987-1991. We hereby reaffirm and emphasize that the Board's policy is to reflect an equitable and appropriate sharing of consolidated tax benefits for ratepayers in future rate proceedings....[3]

The Board reaffirmed its consolidated income tax policy in its Order in the 1991 Jersey Central Power and Light Company ("JCP&L") base rate proceeding, BPU Docket No. ER91121820J, dated February 25, 1993. On pages 7 and 8 of its Order in that docket the BPU stated:

> The Board believes that it is appropriate to reflect a consolidated tax savings adjustment where, as here, there has been a tax savings as a result of the filing of a consolidated tax return. Income from utility operations provide the ability to produce tax savings for the entire GPU system because utility income is offset by the annual losses of the other subsidiaries. Therefore, the ratepayers who produce the income that provides the tax benefits should share in those benefits. The Appellate Division has repeatedly affirmed the Board's policy of requiring utility rates to reflect consolidated tax savings and the IRS has acknowledged that consolidated tax adjustments can be made and there are no regulations which prohibit such an adjustment.
>
> The issue, in this case, is not whether such an adjustment should be made, but, rather, what methodology should be used to make such an adjustment. In this area, the courts have held that the Board has the power and discretion to choose any approach which rationally determines a subsidiary utility's effective tax rate. <u>Toms River Water Company v. New Jersey Public Utilities Commissioners</u>, 158 <u>NJ Super</u> 57 (1978). Based on our review of the record in this case, the Board <u>REJECTS</u> the ALJ's recommendation to accept the income tax expense adjustment proposed by Petitioner and, instead, <u>ADOPTS</u> the position of Staff that the rate base adjustment is a more appropriate methodology for the reflection of consolidated tax savings. The rate base approach properly compensates ratepayers for the time value of money that is essentially lent cost-free to the holding companies in the form of tax advantages used currently and is consistent with our recent <u>Atlantic</u> <u>Electric</u> decision (Docket No. ER90091090J). Moreover, in

[3] *I/M/O the Petition of Atlantic City Electric Company for Approval of Amendments to its Tariff to Provide for and Increase in Rates and Charges for Electric Service, Phase II,* BPU Docket No. ER90091090J, Order Adopting in Part and Modifying in Part the Initial Decision at 8 (Oct. 20, 1992).

> order to maintain consistency with the methodology applied in the Atlantic decision, we modify the Staff calculation and find that a rate base adjustment which reflects consolidated tax savings from 1990 forward, including one-half of the 1990 savings, is appropriate in this case. [4]

In addition, in a more recent 2002 JCP&L base rate case, Docket No. ER02080506, the Board ruled on page 45 of its Final Order:

> As a result of making a consolidated tax filing during the years 1991 – 1999, GPU, JCP&L's parent company during that time period as a whole paid less federal income taxes than it would have is each subsidiary filed separately, thus producing a tax savings. The law and Board policy are well-settled that consolidated tax savings are to be shared with customers.

Finally, in the most recent Rockland Electric Company ("RECO") base rate case, Docket No. ER02100724, the Board again affirmed its consolidated income tax benefit policy. In this regard, the Board stated on page 64 of its Final Order:

> The Board agrees with Staff that RECO's argument that it would be improper to consider data from the period prior to the date of the merger between O&R and Con-Ed (i.e., July 1999) is not valid. RECO's positive net income during the years 1991-1999 clearly produced tax savings for its parent company in those years, and RECO's customers should not be denied their share of these savings simply because of a subsequent merger of its parent with Con-ED.
>
> … the Board **HEREBY ADOPTS** the position of Staff that the $1,329 million rate base adjustment, calculated in accordance with well-settled Board policy, appropriately reflects consolidated tax savings achieved by RECO through offsetting tax losses of affiliates with RECO's positive taxable income. Further the Board **ORDERS** RECO to submit a consolidated tax adjustment in every future base rate case filing. The future consolidated tax adjustments are to be made utilizing the methodology that Staff utilized to calculate its $1.329 million adjustment as shown on Exhibit 4 of this order.

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[4] *I/M/O the Petition of Jersey Central Power & Light Company for Approval of Increased Base Tariff Rates and Charges for Electric Service and Other Tariff Revisions,* BRC Docket No. ER91121820J, Final Decision and Order Accepting in Part and Modifying in Part the Initial Decision at 7-8 (June 15, 1993).

Q. HOW DID YOU DETERMINE THE APPROPRIATE CONSOLIDATED INCOME TAX ADJUSTMENT TO BE APPLIED TO UWNJ FOR RATE MAKING PURPOSES IN THIS CASE?

A. My recommended consolidated income tax benefit adjustment in this case has been determined based upon the calculation methodology that was approved by the Board in its Order in the previously discussed RECO base rate proceeding, BPU Docket No. ER02100724. The calculations were made by the Company in its response to RCR-A-32. As shown in more detail on Schedule RJH-8, that response shows that the consolidated income tax rate base deduction amount as calculated by UWNJ in accordance with the calculation methodology ordered by the Board in the above-referenced RECO rate case amounts to $60,505,116. It is this amount that I recommend be used as a rate base deduction in this case, consistent with previously established Board ratemaking policy.

Q. HAS UWNJ DETERMINED AN ALTERNATIVE CONSOLIDATED INCOME TAX ADJUSTMENT THROUGH AN ALTERNATIVE CALCULATION METHOD?

A. Yes. As shown in the second column of Schedule RJH-8, UWNJ also determined an alternative consolidated income tax adjustment by taking the consolidated income tax benefit calculations in accordance with the Board-ordered "RECO method" as the starting point, but then adjusting this calculation method by limiting the consolidated income tax benefit amounts in any given year to the amount of income tax calculated for UWNJ on a stand-alone basis. Not surprisingly, this alternative calculation method results in a significantly smaller rate base deduction balance of $36,491,025. This alternative consolidated income tax benefit calculation method should be rejected as being inconsistent with the calculation method previously found appropriate by the Board.

Q. WHERE DID YOU REFLECT THIS RECOMMENDED CONSOLIDATED INCOME TAX BENEFIT AMOUNT?

A. This recommended consolidated income tax benefit balance is reflected as a rate base deduction on Schedule RJH-3, line 12.

C. OPERATING INCOME

Q. PLEASE SUMMARIZE THE COMPANY'S PROPOSED PRO FORMA OPERATING INCOME AND YOUR RECOMMENDED OPERATING INCOME ADJUSTMENTS.

A. The Company's proposed pro forma operating income of $34,474,807 is summarized by specific operating income component on Schedule RJH-9. The proposed pro forma operating revenues were normalized based on normal customer usage levels assumed by the Company, and were then annualized based on projected number of customers, hydrants, inch-feet, and sprinklers as of the end of the Pro Forma Year, July 31, 2010. The Company did this in order to match its proposed revenues with the projected rate base plant in service balance as of July 31, 2010. The Company's proposed depreciation expenses were determined by applying its proposed depreciation rates to its projected depreciable plant level (net of plant funded by CIAC and Customer Advances) as of July 31, 2010. The proposed pro forma O&M expenses are either based on the 2010 operating budget or reflect Test Year O&M expenses adjusted for changes deemed to be known and measurable during the year 2010. Generally, the same approach was used by the Company to determine its pro forma revenue taxes and other taxes. The Company's proposed income taxes were determined by taking the proposed net operating income (before income taxes) as the starting point, then deducting pro forma interest expenses through the "interest synchronization" method and applying a federal income tax ("FIT") rate of 35%.

As shown in the middle column of Schedule RJH-9, I have made a large number of recommended adjustments to the Company's proposed pro forma operating revenues, expenses and taxes with the effect of increasing the Company's proposed pro forma operating income by a total amount of $4,619,435. Each of these recommended operating income adjustments will be discussed in detail below.

- **<u>Metered Sales Revenues</u>**

Q. HOW DID YOU DERIVE YOUR RECOMMENDED METERED SALES REVENUES SHOWN ON SCHEDULE RJH-9, LINE 1B?

A. The recommended metered sales revenues represent the annualized and normalized metered sales revenues based on the Company's proposed billing determinants as of the end of the Test Year, 1/31/10. This recommendation is consistent with my reflection of the actual plant in service level at the end of the Test Year, 1/31/10, adjusted only for projected post-Test Year plant additions deemed to be "major in nature and consequence."

Q. HOW DO YOUR RECOMMENDED METERED SALES REVENUES DIFFER FROM THE COMPANY'S PROPOSED METERED SALES REVENUES?

A. As shown on Schedule RJH-9, line 1b, my recommended metered sales revenues are $626,983 lower than the Company's proposed metered sales revenues. I have also recommended variable operating expense decreases associated with my recommended metered sales revenue adjustment. These variable operating expense decreases are quantified on Schedule RJH-22 and will be discussed later on in this testimony.

- **Public and Private Fire Revenues**

Q. HOW DID YOU DERIVE YOUR RECOMMENDED PRIVATE AND PUBLIC FIRE PROTECTION REVENUES SHOWN ON SCHEDULE RJH-9, LINES 1C AND 1D?

A. The recommended private and public fire protection revenues represent the annualized and normalized metered sales revenues based on the Company's proposed billing determinants as of the end of the Test Year, 1/31/10. My recommended combined private and public fire protection revenues are $162,409 lower than the Company's proposed fire protection revenues which are based on projected billing determinants as of the end of the Pro Forma Year, 7/31/10.

- **Labor Expenses**

Q. PLEASE EXPLAIN THE DERIVATION OF YOUR RECOMMENDED LABOR

EXPENSES SHOWN ON SCHEDULE RJH-11.

A. My recommended labor expenses in this case represent the Company's proposed pro forma labor expenses adjusted for (1) a different level for overtime expenses; (2) the removal of all incentive compensation expenses; and (3) the restatements of Labor Transferred In and Labor Transferred Out based on updated 3-year averages.

Q. PLEASE EXPLAIN THE FIRST RECOMMENDED ADJUSTMENT CONCERNING OVERTIME EXPENSES, SHOWN ON SCHEDULE RJH-11, LINE 4.

A. While the Company has proposed to reflect the 2010 budgeted expense levels for Summer Help, Standby labor, and Substitution labor in this case, for overtime expenses it proposes to reflect the average of the overtime expenses experienced in 2007, 2008 and the 12-month period ended 6/30/09. Consistent with the Company's proposed position regarding the Summer Help, Standby labor, and Substitution labor costs, I recommend that the overtime expenses to be reflected for ratemaking purposes in this case similarly be based on the 2010 budget. The overtime expenses included in the Company's 2010 operating budget amount to $2,808,442 and are $1,147,333 lower than the Company's proposed overtime expense level of $3,955,775.

Q. WITH REGARD TO YOUR SECOND LABOR EXPENSE ADJUSTMENT CONCERNING INCENTIVE COMPENSATION, WHAT KINDS OF INCENTIVE COMPENSATION PROGRAMS ARE CURRENTLY IN PLACE FOR THE COMPANY?

A. The Company currently has three incentive compensation programs in effect: the Long Term Incentive Plan (LTIP); the Short Term Incentive Plan (STIP); and the Bonus Plan. The participants in the LTIP incentive compensation program are limited to the Company's senior management employees. The STIP incentive program is available to all active exempt employees in salary grades 12 and above that are not eligible for the LTIP program. The Bonus Plan is available to non-exempt employees. The awards to be paid out under the LTIP are 100% tied to the achievement of United Water's corporate financial performance measures in the form of Earnings Before Interest and Taxes (EBITDA), Return on Investment and revenue growth. The awards to be paid out under the STIP are partially tied to the achievement of United Water's corporate financial performance measures and partially tied to the achievement of personal performance goals. The awards to be paid out under the Bonus Plan are 50% tied to the achievement of business unit financial performance in the form of EBITDA. No incentive compensation will be paid out if less than 80% of the performance measures are achieved.

Q. WHAT PRO FORMA INCENTIVE COMPENSATION LEVEL HAS THE COMPANY PROPOSED IN THE INSTANT PROCEEDING?

A. The Company has proposed total incentive compensation expenses of $2,246,634 in this case, consisting of $1,338,846 of "direct" UWNJ incentive compensation expenses and $907,788 of incentive compensation expenses charged by UWM&S to UWNJ as part of the UWM&S service charges. Of the total $2,246,634 expense amount, $474,489 represents LTIP incentive compensation, $1,508,244 represents STIP incentive compensation, and $263,901 represents Bonus Plan incentive compensation.

Q. PLEASE EXPLAIN YOUR RECOMMENDATION TO ELIMINATE THE $2,246,634 OF INCENTIVE COMPENSATION EXPENSES INCLUDED IN THE COMPANY'S PROPOSED PRO FORMA LABOR EXPENSES AND UWM&S FEES.

A. Incentive compensation expenses are disallowed for ratemaking purposes under current Board policy. In a prior JCP&L base rate proceeding, BPU Docket No. ER91121820J, the Board established the rate making policy that incentive compensation program expenses that are impacted by the achievement of financial performance goals should not be recovered in rates from the ratepayers. In accordance with that ratemaking policy, the Board disallowed all incentive compensation expenses in that prior JCP&L rate case. The Board reiterated this stated ratemaking policy in its Order in a prior Middlesex Water Company rate case, Docket No. WR00060362, where the Board disallowed all incentive compensation expenses for ratemaking purposes. Therefore, my recommendation to remove all incentive compensation expenses in this case is in accordance with BPU ratemaking policy.

I should also note that I find the Company's request in this case for rate recovery in excess of $2.2 in bonus compensation on top of regular compensation particularly egregious to the ratepayers because this proposal is being made in the aftermath of the worst economic downturn since the Great Depression, where ratepayers are faced with job losses, plunging home values, and 401(k)s that have turned into 201(k)s. It is especially during these very difficult economic conditions that ratepayers need relief from these discretionary costs.

Q. PLEASE EXPLAIN YOUR THIRD AND FOURTH LABOR EXPENSE ADJUSTMENTS CONCERNING THE LABOR TRANSFERRED IN AND LABOR TRANSFERRED OUT BASED ON UPDATED 3-YEAR AVERAGES.

A. The Company's proposed normalized Labor Transferred In expenses and Labor Transferred Out expense credits are based on the averages of these expenses and expense credits for the 5-year period 2005, 2006, 2007, 2008 and the 12-month period ended 6/30/09, whereas my recommended expenses and expense credits are based on the updated averages for the 3-year period 2007, 2008 and Test Year ended 1/31/10. In its prior rate cases, including the one just completed in 2009, UWNJ calculated its normalized Labor Transferred In expenses and Labor Transferred Out expense credits based on the averages for the most recent 3-year period available in those cases. However, in the current case, the Company switched to a 5-year historic average approach. Not surprisingly, the 5-year historic averages produce results that are more favorable to UWNJ in this case. I believe this inconsistent "cherry picking" approach is inappropriate and should be rejected by the Board. My recommended 3-year historic average approach should be used by the Board as it is consistent with the approach used for these same two labor cost components in UWNJ's prior rate cases and reflects data for the most recent 3 annual periods, including the Test Year ended 1/31/10.

As shown on Schedule RJH-11, lines 9 and 10, my recommended adjustments decrease the Company's proposed normalized Labor Transferred In expenses by $84,822 and decrease the Labor Transferred Out expense credits by $963,046.

- **Purchased Water Expenses**

Q. PLEASE EXPLAIN YOUR RECOMMENDED PURCHASED WATER EXPENSE ADJUSTMENT SHOWN ON SCHEDULE RJH-10, LINE 2.

A. The recommended purchased water expense adjustment of $796,827 is to correct for an error in the Company's proposed Test Year purchased water expenses. In its response to RCR-A-126, the Company agrees that this error correction should be made in this case.

- **Purchased Power Expenses**

Q. PLEASE EXPLAIN YOUR RECOMMENDED PURCHASED POWER EXPENSE ADJUSTMENT SHOWN ON SCHEDULE RJH-10, LINE 3.

A. As shown on Schedule RJH-10, footnote (3), while the Company's proposed total Test Year purchased power expenses include an amount of $1,597,200 for the Fixed PPL Lease expense that is assumed to be the lease expense included in the 2010 budget, I believe that the correct lease expense included in the 2010 budget amounts to $1,440,480. This is confirmed in the Company's response to RCR-A-91 which shows that the Fixed PPL Lease expense included in the Company's 2010 operating budget is $1,440,480. The Company made the same error in its prior base rate case. In that case, the Company also proposed a Fixed PPL Lease expense amount of $1,597,200, but then conceded in its response to RCR-A-79 in that case that "the projected amount of $1,597,200 was based upon a pre-budget estimate" which subsequently was reduced to $1,484,500. Based on this information, I recommend the purchased power expense adjustment of $156,720 shown on Schedule RJH-10, line 3.

- **Chemical Expenses**

Q. PLEASE EXPLAIN YOUR RECOMMENDED CHEMICAL EXPENSE ADJUSTMENT SHOWN ON SCHEDULE RJH-9, LINE 4.

A. This adjustment represents my adoption of the chemical expense reduction recommended by Rate Counsel witness Howard Woods.

- **Waste Residual Expenses**

Q. PLEASE EXPLAIN YOUR RECOMMENDED WASTE RESIDUAL EXPENSE ADJUSTMENT SHOWN ON SCHEDULE RJH-10, LINE 5.

A. As shown in more detail on Schedule RJH-12, I have made 3 adjustments to the Company's proposed waste residual expenses.

The expense adjustments shown on Schedule RJH-12, lines 1 and 3 reflect required expense corrections that were conceded by UWNJ in its responses to RCR-A-89(b) and RCR-A-128(a).

The expense adjustment shown on line 2 represents a recommended normalized Residual Management expense level that is $735,319 lower than the Company's proposed budgeted

2010 expense level. In the table below, I have compared the Company's actual Residual Management expenses with the equivalent budgeted Residual Management expenses for the same years:

	Actual	Budget
2006	$1,010,176	$1,144,000
2007	869,728	1,225,000
2008	1,407,653	1,620,372
2009	1,607,039	2,448,930

Based on the information shown in this table, I do not believe that the Company's budget for Residual Management expenses can be considered a reliable source upon which to base the future normalized expense level. Accordingly, in deriving the recommended normalized Residual Management expense level, I first took the ratio of the 2009 actual expenses as compared to the 2009 budgeted expenses. This ratio is 65.62%. I then applied this ratio to the budgeted 2010 Residual Management expenses of $2,485,319 (proposed by UWNJ in this case) to arrive at an adjusted 2010 budgeted expense level of $1,630,866. Finally, to be conservative, I increased this adjusted expense level of $1,630,866 to a recommended normalized expense level of $1,750,000.

- **Tank Painting Expenses**

Q. HOW DID THE COMPANY DETERMINE ITS PROPOSED TANK PAINTING EXPENSES?

A. When the Company paints its tanks, it defers the painting costs and amortizes these costs over a 10-year period. As shown on Schedule RJH-13, in this case the Company is claiming tank painting amortization expenses for 8 tanks that were actually painted in the past (shown on lines 4 – 11) and for 3 tanks that are projected to be painted in 2010. The total proposed amortization expense for these 11 tanks is $399,753.

Q. DO YOU RECOMMEND ADJUSTMENTS TO THESE PROPOSED TANK PAINTING EXPENSES?

A. Yes. As stated before, the tank painting expenses shown on Schedule RJH-13, lines 4 through 11 represent the continued 10-year amortization of actual tank painting costs that have been allowed for ratemaking purposes in the Company's prior rate cases. For that reason, I have not adjusted these proposed tank painting expenses. However, the proposed tank painting expenses on lines 1 through 3 represent newly projected tank painting costs for 3 tank paintings in 2010. While the Company has proposed to amortize these projected tank painting costs over 10 years, I recommend an amortization period of 20 years. As shown on Schedule RJH-13, my recommendation reduces the Company's proposed tank painting expenses in this case by $60,000.

Q. WHY DO YOU RECOMMEND THAT THESE NEW TANK PAINTING COSTS BE AMORTIZED OVER 20YEARS RATHER THAN 10 YEARS?

A. The Company's proposed 10-year amortization period is based on its claim that its "water storage tanks normally require painting approximately every ten years."[5] However, workpaper SIR-27 and the response to RCR-A-66 indicate that the frequency of the Company's actual tank paintings ranges between 20 and 30 years. Based on this

[5] Testimony of David G. Njuguna, page 22, lines 18 – 19.

information, I recommend that, starting with the projected three new tank paintings in the current case, all of UWNJ's future tank painting costs should be amortized over a 20-year rather than a 10-year period.

- **Transportation Expenses**

Q. HOW DID THE COMPANY DERIVE ITS PROPOSED PRO FORMA TRANSPORTATION EXPENSES?

A. As shown on SIR-28A, the Company used a variety of projection methodologies to determine its pro forma transportation expenses in this case. For the insurance and depreciation transportation expense portions of the transportation function, the 2009 Operating Plan and 2010 Operating Budget were used; the payroll expense portion was based on 3% of the labor expenses proposed in this case; the lease expenses were based on the 2010 lease schedule; and the remaining transportation expenses were based on the 3-year average for 2007, 2008 and 6/30/09, increased by an inflation factor. The Company then applied a capitalization ratio of 48.87% to remove the capitalized portion of its proposed transportation expenses.

Q. DO YOU RECOMMEND ADJUSTMENTS TO THE COMPANY'S PROPOSED TRANSPORTATION EXPENSES?

A. Yes. While I have accepted the Company's proposed lease and depreciation transportation expense components, I recommend that adjustments be made to the other transportation expense components. Specifically, for those expense components that UWNJ based on the inflation adjusted 3-year average for 2007, 2008 and 6/30/09, I used updated 3-year averages for the more recent 3-year period 2007 through 1/31/10; for the payroll portion of the transportation expense I used the same 3% but applied to Rate Counsel's recommended labor expenses in this case; and for the capitalization ratio, I used a ratio of 49.78% based on the more updated 3-year average for the period 2007 through 1/31/10 that was previously discussed in the Labor Expense section of this testimony.

As shown on Schedule RJH-14, my recommended expense adjustments reduce the Company's proposed pro forma transportation expenses by $151,191.

- **Uncollectible Expenses**

Q. PLEASE EXPLAIN YOUR RECOMMENDED UNCOLLECTIBLE EXPENSE ADJUSTMENT SHOWN ON SCHEDULE RJH-10, LINE 8.

A. My recommended uncollectible expense adjustment is merely a "flow-through" adjustment resulting from applying the Company's proposed uncollectible expense ratio to my recommended operating revenue adjustments discussed previously in this testimony.

- **Outside Services Expenses**

Q. DO YOU RECOMMEND THAT ADJUSTMENTS BE MADE TO THE COMPANY'S PROPOSED OUTSIDE SERVICES EXPENSES?

A. Yes. The detailed components of the Company's proposed outside services expenses are shown on Schedule RJH-15. All of the Company's proposed outside services expense components are based on the 2010 Operating Budget. I have accepted all of these proposed outside services expenses, except for the "Other" expense component. I recommend that this latter expense be based on the average for the most recent 3-year period from 2007 through 1/31/10. I am making this recommendation because the projected 2010 expense level for this latter expense is so much higher than the actual historic expense levels, and the Company has not provided any particular reasons as to why this projected expense level should be considered representative of what can be expected in the rate effective period.

- **Property and Liability Insurance**

Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENT FOR INSURANCE OTHER THAN GROUP EXPENSES SHOWN ON SCHEDULE RJH-16.

A. The recommended adjustment is to reflect a final budget update for this expense that should be reflected in this case, as confirmed by the Company in its response to RCR-A-120.

- **Injury and Damages Expenses**

Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENT FOR INJURY AND DAMAGES (I&D) EXPENSES SHOWN ON SCHEDULE RJH-10, LINE 12.

A. The Company's proposed I&D expenses of $981,439 are based on the average expense level for the years 2007, 2008 and 12-month period ended 6/30/09. Since I&D expenses are the type of expenses that can fluctuate significantly from year to year, I believe it is appropriate to consider a longer historic period to reasonably project an appropriate normalized future expense level. The 5-year average I&D expense level for the period 2005 through 1/31/10 amounts to $872,399. This is slightly lower than the $919,000 I&D expense level included in the Company's 2010 Operating Budget. To be conservative, I recommend the reflection of the 2010 budgeted I&D expense level of $919,000 for ratemaking purposes in this case.

- **Employee Pensions and Benefits**

Q. HAVE YOU MADE ADJUSTMENTS TO THE COMPANY'S PROPOSED EMPLOYEE PENSION AND BENEFIT EXPENSES IN THIS CASE?

A. Yes, the Company's proposed employee pensions and benefits expense components and my recommended adjustments are shown on Schedule RJH-17. As shown on this schedule, I recommend that the Company's employee pension and benefit expenses be adjusted in three respects.

The first recommended pension expense adjustment on Schedule RJH-17, line 3 reflects my adoption of the recommendation made by Rate Counsel witness Mitch Serota with regard to the expenses associated with the Company's qualified pension plan.

The second recommended Other Benefits expense adjustment on line 5 reflects a required correction for an error in the Company's Other Benefits expense projection, as conceded by the Company in its response to RCR-A-125.

The third recommended expense adjustment reflects the removal of the proposed amortization of UWNJ's deferred 2009 pension expenses.

Q. PLEASE EXPLAIN THE HISTORY BEHIND THE THIRD RECOMMENDED ADJUSTMENT WITH REGARD TO UWNJ'S PROPOSED AMORTIZATION OF DEFERRED 2009 PENSION EXPENSES.

A. The Company's prior rate case was resolved by stipulation which awarded UWNJ a rate increase of $26.5 million. The pension expenses that were included for ratemaking purposes in this stipulated rate increase amounted to $410,016, representing the 2009 pension expenses estimated by UWNJ's actuary. Shortly after the stipulated rate increase amount had become final, the Company learned from its actuary that its 2009 pension expenses would be approximately $4 million[6] rather than the previously estimated expense amount of $410,016. The Company then requested to be allowed to defer, for accounting purposes only, the difference between the actual 2009 pension expenses and the annual pension expense level of $410,016 included in rates. This deferral mechanism would only be applicable to the 2009 pension expense and would expire on 12/31/09. The Company also requested that any of such deferred pension expenses be considered for amortization in the Company's next base rate case. The Signatory Parties to the stipulation agreed to include a provision in the stipulation allowing this request. In its *Order Adopting Initial*

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[6] This still represented an estimated expense amount, albeit an updated and revised one, since the final actual expense amount would not be known until the end of 2009.

Decision/Stipulation dated 4/3/09, the Board stated with regard to this stipulation provision:

> The Board ACCEPTS the Company's request for deferred accounting treatment for accounting purposes only, with respect to the Company's current actuarially derived 2009 shortfall in its pension costs, until such time as these data can be more completely analyzed. The Board shall determine an amortization period, if any, in the Company's next base rate proceeding.

The Company's final actual pension costs for 2009 amounted to $4,080,132, or $3,670,116 higher than the estimated 2009 pension cost of $410,016 included in UWNJ's rates. The Company deferred this pension cost difference and, in the current case, is proposing to amortize this deferred pension cost of $3,670,116 in rates to the ratepayers over a 3-year period. Thus, in this case, the Company has reflected a proposed annual amortization expense of $1,223,372.[7]

Q. IS THERE A CALCULATION ERROR IN THE COMPANY'S PROPOSED AMORTIZATION EXPENSE OF $1,223,372?

A. Yes. The proposed amortization expense of $1,223,372 erroneously ignores the fact that only approximately one-half of the Company's 2009 pension costs are charged to O&M expense. The other half is capitalized and should not be part of the deferral and amortization proposal of UWNJ. This fact is confirmed and conceded by UWNJ in its response to RCR-A-82. From this same data response it can be determined that the correct annual deferred pension cost amortization, calculated without the cost portion that is transferred to capital, amounts to approximately $638,000 rather than the annual

[7] Calculation: $3,670,116 / 3-year amortization period = $1,223,372.

amortization expense of $1,223,372 proposed by UWNJ.

Q. ARE YOU THEREFORE RECOMMENDING RATE RECOGNITION FOR THIS CORRECTED ANNUAL EXPENSE AMORTIZATION OF $638,000?

A. No, I recommend that none of the deferred 2009 pension expense shortfall be recognized in rates in this case.

Q. DOES THIS RECOMMENDED POSITION VIOLATE THE PRIOR CASE STIPULATION REGARDING THIS ISSUE?

A. I do not believe so. Both the stipulation and the Board Order clearly state that the pension cost deferral was allowed *for accounting purposes only* and that any rate recognition for these deferred cost could be *considered* in the next base rate case. Rate Counsel has carefully considered this issue and has concluded that it would be inappropriate and inequitable to the ratepayers to award future rate recognition for these deferred costs.

Q. PLEASE EXPLAIN THE REASONS FOR THIS RECOMMENDED POSITION.

A. It is important to recognize that if the Company's proposed single-issue ratemaking approach had been in effect during the years prior to 2009, the ratepayers would have received cumulative rate credits of approximately $45.6 million as the Company significantly over-recovered its pension costs during that time. However, the ratepayers never received these rate credits. Rather, this cumulative pension expense over-recovery amount of almost $46 million flowed straight to the stockholders. Given this history, it is inappropriate and inequitable to charge the ratepayers for pension cost under-recoveries now that the Company has finally experienced a pension cost shortfall in 2009.

Q. PLEASE PROVIDE SOME MORE DETAIL REGARDING THE COMPANY'S PENSION COST OVER-RECOVERIES PRIOR TO THE YEAR 2009.

A. As shown in the response to RCR-A-81, the Company's rates set in its 1995 rate case (BPU Docket No. WR95070303) included a pension expense credit of ($38,876); the Company's rates set in its next rate case, the 2007 rate case (BPU Docket No. WR07020135), included a pension expense credit of ($1,965,109); and the Company's rates set in its most recent rate case, the 2008 rate case (BPU Docket No. WR08090710), included a pension expense charge of $410,016. In the table below, I have compared the Company's actual pension expenses during the 13-year period from 1996 through 2008 to the pension expenses included in rates for this same 13-year period:

	Actual Exp/(Credit)	Exp/(Credit) in Rates	Under/(Over)-Recovery
1996	$(2,985,273)	$(38,876)	$(2,946,397)
1997	(3,746,936)	(38,876)	(3,708,060)
1998	(5,397,499)	(38,876)	(5,358,623)
1999	(6,573,355)	(38,876)	(6,534,479)
2000	(8,010,625)	(38,876)	(7,971,749)
2001	(6,786,568)	(38,876)	(6,747,692)
2002	(4,345,252)	(38,876)	(4,306,376)
2003	(1,379,382)	(38,876)	(1,340,506)
2004	(914,263)	(38,876)	(875,387)
2005	(1,461,379)	(38,876)	(1,422,503)
2006	(1,989,065)	(38,876)	(1,950,189)
2007	(1,925,552)	(38,876)	(1,886,676)
2008	(2,548,201)	(1,965,109)	(583,092)
Total cumulative pension cost over-recovery:			$(45,631,729)

Thus, during the 13-year period prior to 2009, the Company over-recovered its pension costs by $45.6 million, but never petitioned the Board for a deferral mechanism to capture these pension cost over-recoveries. By contrast, when the pension cost over-recoveries finally changed to a pension cost under-recovery of approximately $3.67 million in 2009, the Company requested a deferral mechanism for the cost recovery shortfall and is now proposing that this retroactive cost shortfall be charged to the ratepayers on a going forward basis. This proposed ratemaking approach not only represents inappropriate retroactive ratemaking, it is also patently unfair to the ratepayers and should not be allowed by the Board.

Q. WHILE THE COMPANY IS CLAIMING A 2009 PENSION COST OF APPROXIMATELY $4.1 MILLION THAT RESULTED IN THE $3.7 MILLION COST SHORTFALL WHICH IT IS PROPOSING TO CHARGE TO THE RATEPAYERS, WHAT WAS UWNJ'S ACTUAL CASH CONTRIBUTION TO THE PENSION FUND IN 2009?

A. The Company's actual cash contribution to the pension fund in 2009 amounted to only $$436,605[8], or approximately $3.7 million less than its claimed 2009 pension cost of $4.1 million. In fact, the Company's actual cash contribution to its pension fund in 2009 was almost equal to the 2009 pension pension expense of $410,016 for which the Company received rate recovery in 2009. This is another reason why the Company's proposed rate recognition of the 2009 deferred pension cost shortfall should be rejected. It is inappropriate and inequitable to have the ratepayers fund a claimed pension cost shortfall in 2009 of $3.7 million when, during the same year, the Company's actual pension fund cash

[8] Email dated May 27, 2010 from Mr. Cagle to Mr. Henkes

contribution was equal to the pension cost level that was included in rates.

- **Regulatory Commission Expenses**

Q. PLEASE DESCRIBE THE COMPANY'S PROPOSED PRO FORMA REGULATORY COMMISSION EXPENSES IN THIS CASE.

A. The Company's proposed pro forma regulatory commission expenses are shown in detail on Schedule RJH-18. First, the Company proposes total estimated rate case expenses of $865,000 to be amortized over a 3-year period. These projected rate case expenses are for the following rate case expense components:

UWM&S charges	$275,000
Legal Services	500,000
Rate of Return Consultant	25,000
Cust. Notification, Transcripts	30,000
Consulting Services	35,000
Total	$865,000

Second, the Company proposes pro forma BPU and Rate Counsel assessments by applying the current BPU and Rate Counsel assessment ratios to its proposed pro forma revenues. The Company's proposed total annual regulatory commission expenses in this case amount to $646,853.

Q. DO YOU RECOMMEND THAT ADJUSTMENTS BE MADE TO THE COMPANY'S PROPOSED REGULATORY COMMISSION EXPENSES?

A. Yes. I first recommend that the Company's proposed UWM&S charges of $275,000 be removed. The UWNJ ratepayers are already paying approximately $9.8 million for

UWM&S fees allocated to UWNJ under the Service Agreement between UWM&S and UWNJ. Article I-K of the Service Agreement indicates that, as part of the $9.8 million UWNJ pays UWM&S, UWNJ will receive the following services from UWM&S:

> Service Company will advise and assist in the preparation of rate schedules for Utility Company's services; will prepare, or assist in preparing, the material and exhibits required for the Utility Company's rate cases and render advice with respect to the procedure therein and will, at the request of Utility Company, arrange for the employment of such witnesses as may be required.

Given that the UWNJ ratepayers are already paying for UWM&S's assistance in UWNJ's rate cases as part of the $9.8 million management service fees, I believe it is patently unfair to have them pay another $275,000 in ad hoc pro forma rate case assistance expenses.

The second rate case expense component that I recommend be adjusted in this case concerns the Company's proposed legal expenses of $500,000. The $500,000 expense estimate is for one external legal firm. When the Company was asked in RCR-A-73 for the number of legal hours underlying the $500,000, as well as the basis for this very high expense estimate, it responded that the $500,000 expense estimate is not tied to a specific number of hours but, rather, is …"based upon the recent experience of large water companies processing full rate cases before the Board of Public Utilities." The actual legal expenses incurred in the Company's most recent and second most recent prior rate cases amounted to approximately $111,000 and $304,000, respectively. Based on the foregoing information, I have conservatively reflected a recommended rate case legal expense level of $300,000 for the current case.

Next, in accordance with well-established and long-standing Board ratemaking policy, I recommend that the rate case expenses be shared on a 50/50 basis between the Company's stockholders and ratepayers. This is shown on line 10 of Schedule RJH-18.

Finally, my recommended pro forma BPU and Rate Counsel assessments are slightly different from the Company's proposed assessments because of the difference between my recommended and the Company's proposed pro forma operating revenues in this case. This is shown on lines 14 – 15.

As shown on Schedule RJH-18, the end result of the previously discussed recommended adjustments is a reduction in the Company's proposed regulatory commission expenses of $224,979.

- **Management & Services Fees**

Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENTS TO THE COMPANY'S PROPOSED MANAGEMENT AND SERVICES (UWM&S) FEES SHOWN ON SCHEDULE RJH-19.

A. As shown on Schedule RJH-18, I recommend that five adjustments be made to the Company's proposed UWM&S fees of $9,800,501.

The first adjustment concerns the recommended restatement of the Company's proposed UWM&S fees based upon its 2009 Operating Budget. As shown in the response to RCR-

A-63, the Company's actual UWM&S fees from 2005 through 2009 have consistently been below the budgeted UWM&S fees for the same years. For the year 2009, the actual UWM&S fees turned out to be $8,893,287, or only 90.74% of the budgeted 2009 fees of $9,800,501 upon which the Company based its pro forma UWM&S fee level in this case. Based on this information, I have calculated the recommended UWM&S fee starting point in this case by applying the historic actual-to-budget ratio of 90.74% to the UWM&S fees of $10,341,488 included in the Company's 2010 Operating Budget. This produces a recommended adjusted UWM&S fee level of $9,384,196, which is $416,305 lower than the Company's proposed UWM&S fee level of $9,800,501. My calculations for the recommended adjusted UWM&S fee level of $9,384,196 are shown on Schedule RJH-19, footnote (2). As shown on Schedule RJH-19, the recommended adjusted UWM&S fee level is 95.75% of the comparable Company's proposed UWM&S fee level of $9,800,501.

Second, for the reasons previously discussed in this testimony, I recommend the removal of all incentive compensation expenses included in the UWM&S fees. As described in the response to RCR-A-64, these incentive compensation expenses total $907,788, consisting of $581,379 for short term bonuses ("STIP") and $326,409 for long term bonuses ("LTIP"). Since my first adjustment resulted in a recommended UWM&S fees starting point that is 95.75% of the Company's proposed UWM&S fees, I have applied this same 95.75% ratio to my recommended UWM&S incentive compensation removal adjustment of $907,788, resulting in a net recommended incentive compensation removal adjustment of $869,207.

Third, I have removed public and community relations expenses of $283,239 from the UWM&S fees. These promotional and institutional expenses should not be charged to the Company's ratepayers as their primary purpose is to promote goodwill for the Company and enhance the Company's image as a good corporate citizen. They have nothing to do with the provision of safe, adequate and reliable water service. My recommendation is consistent with Board ratemaking policy to exclude promotional and institutional expenses for ratemaking purposes. As shown in footnote (4) of Schedule RJH-19, the removed expense of $283,239 was calculated by applying the same 95.75% to the actual test year UWM&S public and community relations expenses of $312,143.

Fourth, I have removed $45,378 worth of lobbying expenses from the UWM&S fees. This $45,378 expense amount consists of the annual compensation and benefit expenses of $47,392 charged to UWNJ associated with UWM&S's Vice-President of External Affairs, multiplied by the same 95.75% ratio. In the response to RCR-A-65, the Company has confirmed that this UWM&S employee's primary function is lobbying at the state and local levels.

Finally, I have removed $18,073 for SERP (Supplemental Executive Retirement Plan) expenses that were inadvertently still included in the UWM&S fees charged to UWNJ. These represent expenses that should not be borne by the ratepayers. As shown in footnote (6) of Schedule RJH-19, the removed expense of $18,073 was calculated by applying the same 95.75% to the actual test year UWM&S SERP expense of $18,875.

- **Fringe Benefit/G&A Expense Transfers**

Q. PLEASE EXPLAIN YOUR RECOMMENDED FRINGE BENEFIT/G&A EXPENSE TRANSFERS ADJUSTMENT SHOWN ON SCHEDULE RJH-20.

A. There are two reasons for the difference between my recommended and the Company's proposed fringe benefit/G&A expense transfers. The first reason is the difference in our respective fringe benefit/G&A expense levels to which the normalized fringe benefit/G&A transfer ratio is applied. The second reason is the result of a capitalization ratio of 49.78% as opposed to UWNJ's proposed capitalization ratio of 48.87%. The reason for the difference in these two capitalization ratios was explained earlier in the Labor Expense section of this testimony.

- **Other O&M Expenses**

Q. HOW DID THE COMPANY DETERMINE ITS PROPOSED OTHER O&M EXPENSES IN THIS CASE?

A. The Company determined its pro forma Other O&M expenses of $12,165,875 in this case by taking the average Other O&M expenses of the three years 2006, 2007 and 2008 and then applying an inflation factor of 2.98% to this 3-year average.

Q. DO YOU RECOMMEND A DIFFERENT OTHER O&M EXPENSE LEVEL IN THIS CASE?

A. Yes. In accordance with previously established BPU ratemaking policy, my recommended

Other O&M expense level has not been calculated using a blanket inflation factor. Instead, I determined the recommended Other O&M expense level based on the average of the most recent 3-year period 2007 through 1/31/10. As shown on Schedule RJH-10, line 18, this produced a recommended expense level of $14,062,056, which is $1,896,181 higher than the Company's proposed expense level of $12,165,875.

Q. WHY IS THERE SUCH A LARGE DIFFERENCE BETWEEN THE COMPANY'S PROPOSED AND YOUR RECOMMENDED OTHER O&M EXPENSE NUMBERS?

A. As indicated in the Company's response to RCR-A-51(a) Updated 5/27/10, the Company made some very large errors in the determination of its annual Other O&M expenses. My recommended 3-year average Other O&M expense level reflects the correct annual Other O&M expenses whereas the Company's proposed Other O&M expense level is based on erroneous data.

- **Miscellaneous Expense Adjustments**

Q. PLEASE EXPLAIN THE MISCELLANEOUS EXPENSE ADJUSTMENTS SHOWN ON SCHEDULE RJH-21.

A. On Schedule RJH-21, lines 1 through 9, I have removed various expenses included in the Company's proposed above-the-line operating expenses that have nothing to do with the provision of safe, adequate and proper service, and that have previously been disallowed for ratemaking purposes by the Board. These expenses involve charitable contributions of

$265,000 (line 1); lobbying expenses of $150,000 (line 2); expenses for gifts, awards, and service recognition dinners of $90,000 (line 3); the lobbying portions of NAWC and NJUA dues totaling $24,048 (lines 4 and 5); various institutional expenses amounting to $11,800 (line 6 and footnote 1); charitable dues expenses of $95,200 (line 7 and footnote 2); the 3-year amortization of the 50% ratepayer share of gains on sales of utility property previous included in rate base;[9] and various expenses included in Account 930.

On Schedule RJH-21, line 8, I have amortized over 5 years 50% of the net gain that accrued to the Company from the sale of a utility property that had previously been supported in rates by the ratepayers. This recommendation is consistent with BPU policy that such utility property gains be shared on a 50/50 basis between ratepayers and stockholders.

- **Expense Increase Associated With Revenue Adjustment**

Q. PLEASE EXPLAIN THE EXPENSE ADJUSTMENT SHOWN ON SCHEDULE RJH-22.

A. This adjustment is to reflect the incremental variable expenses associated with my recommended metered sales revenue adjustment discussed earlier in this testimony. All of the calculations and source references in support of this expense adjustment are shown on Schedule RJH-22.

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[9] This recommendation is consistent with established BPU policy that such utility property gains be shared on a 50/50 basis between ratepayers and stockholders.

- **<u>MTBE Amortization</u>**

Q. PLEASE EXPLAIN THE MTBE AMORTIZATION ADJUSTMENT SHOWN ON SCHEDULE RJH-10, LINE 21.

A. This adjustment reflects the agreed upon 40-year amortization of the so-called MTBE proceeds received by UWNJ. As confirmed in its response to RCR-A-14, the Company inadvertently failed to reflect this amortization and agrees that an annual expense credit amount of $71,088 should be reflected for this MTBE proceeds amortization.

- **<u>Depreciation Expenses</u>**

Q. PLEASE EXPLAIN THE DERIVATION OF YOUR RECOMMENDED PRO FORMA DEPRECIATION EXPENSES IN THIS CASE.

A. As shown on Schedule RJH-23, the recommended pro forma depreciation expenses have been calculated by me using the same calculation method as used by UWNJ, but basing the annualized depreciation expense calculations on the recommended depreciable plant (net of contributed plant) reflected in this case.

- **<u>Revenue Taxes</u>**

Q. PLEASE EXPLAIN YOUR RECOMMENDED REVENUE TAX ADJUSTMENT SHOWN ON SCHEDULE RJH-9, LINE 5.

A. This recommended adjustment represents the revenue tax impact of my recommended test year operating revenue adjustments. Schedule RJH-9, footnote (3) explains the calculations in support of this recommended revenue tax adjustment.

- **Property Taxes**

Q. PLEASE EXPLAIN YOUR RECOMMENDED REVENUE TAX ADJUSTMENT SHOWN ON SCHEDULE RJH-9, LINE 6.

A. This recommended adjustment represents the reflection of a correction for an error contained in the calculations of the Company's proposed property taxes. The Company concedes in its response to RCR-A-26(d) that this correction should be made.

- **Payroll Taxes**

Q. PLEASE EXPLAIN YOUR RECOMMENDED PAYROLL TAX ADJUSTMENT SHOWN ON SCHEDULE RJH-9, LINE 7.

A. This recommended adjustment represents the payroll tax impact of my recommended labor expense adjustment. Schedule RJH-9, footnote (5) explains the calculations in support of this recommended payroll tax adjustment.

- **Income Taxes**

Q. WHAT ARE THE REASONS FOR THE DIFFERENCE BETWEEN YOUR

RECOMMENDED PRO FORMA INCOME TAXES AND THE COMPANY'S PROPOSED PRO FORMA INCOME TAXES TO BE USED FOR RATE MAKING PURPOSES IN THIS CASE?

A. As shown on Schedule RJH-24, I have used the same methodology and calculation components as those used by the Company to derive the recommended pro forma income taxes. The difference between the recommended pro forma income taxes and the Company's proposed pro forma income taxes is simply caused by: (1) the "flow-through" effect of the recommended adjustments made by me to the Company proposed operating income before income taxes; and (2) the different levels of tax-deductible pro forma interest expenses as a result of differences in rate base and weighted cost of debt.

D. PENSION/OPEB EXPENSE DEFERRAL MECHANISM

Q. PLEASE DESCRIBE THE PENSION/OPEB DEFERRAL AND RECONCILIATION MECHANISM THE COMPANY HAS PROPOSED IN THIS CASE.

A. In this case, UWNJ has proposed a deferral and reconciliation mechanism that would allow the true-up of the Company's actual annual pension and OPEB expenses to the annual pension and OPEB expense levels recovered in rates. The proposed deferral and reconciliation mechanism is addressed on pages 18 – 19 of the testimony of UWNJ witness Jim Cagle and will operate in the following way:

1) The current base rate case will establish a revenue level sufficient to recover the level of pension and OPEB expenses included by UWNJ in its proposed pro forma test year operating expenses;
2) Any difference between the Company's actual annual pension and OPEB expenses (established by UWNJ's actuary in accordance with FASB 87 and FASB 106) and the pension and OPEB expenses included in base rates to be established in this case will be deferred;
3) In the next and all subsequent UWNJ rate cases, the deferred pension/OPEB balances (which could be either net under-recovery or net over-recovery balances) would be amortized to the ratepayers over BPU-approved amortization periods.

Q. PLEASE STATE YOUR OVERALL RECOMMENDATION REGARDING THE COMPANY'S PROPOSED DEFERRAL AND RECONCILIATION MECHANISM.

A. I recommend that UWNJ's proposed deferral and reconciliation mechanism be rejected by the Board as this proposed rate mechanism:

a) Represents inappropriate single-issue ratemaking;
b) Is in violation of accepted ratemaking principles and inconsistent with appropriate regulatory policy;
c) Represents a request for an extraordinary remedy that is not warranted and is unsubstantiated; and
d) Reduces the Company's incentive to manage its pension/OPEB plans and associated expenses in the most efficient manner and at the lowest possible cost.

Q. WHY DOES UWNJ'S PROPOSAL REPRESENT INAPPROPRIATE SINGLE-ISSUE RATEMAKING?

A. A very important principle of proper ratemaking is the principle of "matching" all of the components in the ratemaking formula. In other words, at the time rates are set or changed, all of the ratemaking components that determine a utility's revenue requirement within a defined test period must be considered and subjected to regulatory review. The proposed deferral and reconciliation mechanism violates this matching principle because it would permit UWNJ to reflect for ratemaking purposes retroactive expense changes experienced between rate cases based on the consideration of only two selected ratemaking components (pension and OPEB expenses) without considering changes in all other ratemaking components during the same time period. Under a proper regulatory process, the appropriate measure is not whether one or two single cost elements have changed, but rather whether an appropriate rate of return is being achieved. Thus, the proposed deferral and reconciliation mechanism would inappropriately change prospective rates without regulatory scrutiny of <u>all</u> of UWNJ's revenue requirement components during the same time period and could result in an achieved return higher than justified if all components of the ratemaking formula had been considered. This single-issue ratemaking proposal is inappropriate and should be rejected by the Board.

Q. WHY IS THE COMPANY'S PROPOSED DEFERRAL AND RECONCILIATION MECHANISM IN VIOLATION OF ACCEPTED RATEMAKING PRINCIPLES AND INCONSISTENT WITH APPROPRIATE REGULATORY POLICY?

A. The Company's pension and OPEB expenses represent ordinary business expenses that have traditionally been recovered in the Company's base rates in the same way as other ordinary operating expenses such as wages and salaries, medical expenses, insurance expenses, outside services expenses, maintenance expenses, *etc*. The appropriate ratemaking approach for this type of routine operating expense is for the Board to determine, based on the best information available in the record at the time it makes its determination, an appropriate annual expense level that is representative of the expense level that can reasonably be expected during the rate effective period.

The proposed true-up mechanism represents a drastic move away from this traditional regulatory approach. It seeks a guaranteed, dollar-for-dollar recovery of selective costs incurred between rate cases. One of the most important tenets of ratemaking is that utilities are not <u>guaranteed</u> cost recovery; rather, the ratemaking process entitles the utility no more than a <u>reasonable</u> <u>opportunity</u> to recover its costs and earn a fair rate of return. Regulation is not intended to be a mechanism whereby a utility is guaranteed dollar-for-dollar recovery of its costs. This inappropriate kind of regulation is generally referred to as reimbursement ratemaking. Instead, traditional regulation is based on the principle that the utility has an opportunity to recover its costs and earn its rate of return. It is poor regulatory policy to guarantee revenue requirement recovery because the achievement of safe, adequate and proper utility services at the lowest possible cost requires that a company exert itself and work efficiently; and I believe that the Company will be less likely to do so if it is guaranteed that the consequences of its operating decisions are immune from any cost recovery risks.

By proposing the pension/OPEB expense true-up mechanism, UWNJ has disregarded the foundation upon which the regulatory process was developed, that is, that regulation is supposed to be a substitute for competition. This principal of regulation was designed to stimulate a utility to act as it would if it were in a competitive industry. Clearly, if a utility's cost recovery is guaranteed, this represents a departure from traditional ratemaking foundations. Competitive entities do not have any such cost recovery guarantees. Regulation is intended to take the place of competition, therefore, regulated entities should not receive guaranteed cost recovery if such guarantees are not available in the competitive marketplace.

In summary, this issue represents an important policy decision to be made by the Board in this case. Either the Board can retain the current regulatory process, where the risks and rewards of the efficient operation of the Company remain with the utility and which provides the utility the *opportunity* to recover its costs, or it can resort to reimbursement ratemaking which shifts all the risks to the ratepayers and guarantees dollar-for-dollar recovery of the utility's pension and OPEB costs. For all of the preceding and following reasons, I would respectfully urge the Board to favor the first alternative.

Q. HAS THE BOARD PREVIOUSLY RULED ON A SIMILAR REQUEST BY A NEW JERSEY UTILITY TO RECEIVE GUARANTEED RATE RECOVERY FOR PENSION AND OPEB EXPENSES?

A. Yes. Back in 1992, the Board approved a settlement in a Rockland Electric Company rate proceeding which settlement allowed a true-up mechanism for Rockland Electric's OPEB and Pension expenses. However, in a subsequent Rockland base rate proceeding completed in 2003, BPU Docket No. ER02080614, the Board reversed course and disallowed this tracker mechanism. With regard to this issue, the Board made the following ruling on page 66 of its Final Decision and Order in that case:

> "... an additional pension expense related issue in this case is RECO's proposal to continue to defer the difference between pension expenses allowed in rates and actual pension expenses in accordance with the terms of a Settlement Agreement it entered into in its 1992 rate case, BPU Docket No. ER91030356J…
>
> "The RPA argued that there is no compelling reason why this deferred accounting mechanism, established in the context of a rate case settled over a decade ago, should continue. It asserted that pension expenses should be treated the same as any other expenses, such as wages, salaries, medical and dental expenses and outside consultants. It is well established that the appropriate ratemaking formula for expenses of this sort is for the Board to determine an appropriate annual level of rate recovery based on the record presented during a rate case…."
>
> … the Board **HEREBY FINDS** that there no longer exists any reason to continue treating RECO's OPEB and pension expenses differently from any other expense item included in the cost of providing service to customers. Accordingly, the Board **HEREBY DIRECTS** RECO to cease its deferred accounting treatment for pension expense and OPEBs relative to the difference between the amounts allowed in rates for pension expense and OPEBs and the corresponding expenses booked.

Since this 2003 ruling, the Board has not changed its position on this issue, not for RECO or for any other utility in New Jersey. My recommendation in this case that the Company's proposed deferral and reconciliation mechanism be rejected is consistent with current Board policy on this issue.

Q. HAS THE COMPANY SUBSTANTIATED THE NEED FOR THE PROPOSED DEFERRAL AND RECONCILIATION MECHANISM?

A. No. The proposed deferral and reconciliation mechanism is essentially a request by UWNJ for extraordinary rate relief. As I explained before, traditional ratemaking involves the establishment of a base rate that allows the utility a reasonable opportunity to recover its cost of service and to earn a fair rate of return, but does not guarantee either. Both the risk and reward of the efficient operation of the company are on the utility when the cost of service is recovered through base rates without an accompanying true-up mechanism for selected cost elements. From a regulatory policy standpoint, the impact of a cost true-up mechanism established in the context of a general rate case - where the base rates are set based on traditional principles of ratemaking - is to declare that the general rates established in the case cannot in and of themselves be fair, just and reasonable because the revenue requirement covered by the true-up mechanism cannot be accommodated within the traditional ratemaking process. Typically, the use of deferral and reconciliation mechanisms to provide a utility with extraordinary rate relief have been limited to costs of service that have a significant impact on the utility's financial condition. These are the properties that underlie the most commonly utilized true-up mechanisms such as fuel adjustment clauses and gas cost recovery clauses. Extraordinary rate relief through an automatic deferral and reconciliation mechanism should be allowed only when warranted by conditions that could jeopardize the financial well-being of the utility.

UWNJ's proposed pension/OPEB true-up mechanism does not meet this requirement. In the table below, I have listed the Company's actual pension O&M expenses and OPEB O&M expenses as percentages of the Company's total actual O&M expenses from 2005 through the 2009 test year:

	Actual Pension Expense ($000)[10]	Actual Total O&M Expense ($000)[11]	Percentage Pension Exp. vs Total O&M Exp.
2005	(1,461)	59,444	(2.46) %
2006	(1,989)	60,254	(3.30)
2007	(1,926)	65,694	(2.93)
2008	(2,548)	69,073	(3.69)
2009	4,080	75,693	5.39
Cumulative	(3,844)	330,158	(1.16)

	Actual OPEB Expense ($000)[12]	Actual Total O&M Expense ($000)	Percentage OPEB Exp. vs Total O&M Exp.
2005	2,919	59,444	4.91%
2006	2,985	60,254	4.95
2007	3,141	65,694	4.78
2008	3,326	69,073	4.82
2009	2,697	75,693	3.56
Cumulative	15,068	330,158	4.56

As shown in the above table, during the last 5 years, from 2005 through 2009, the Company's pension O&M expenses have averaged a negative 1.16% of the Company's total O&M expenses; and the Company's OPEB O&M expenses have averaged only 4.56% of the Company's total O&M expenses. Thus, I do not believe that these expense items are material enough to warrant the extraordinary rate treatment proposed by the Company in the form of the deferral and reconciliation rate mechanism. In addition, the Company has not provided evidence in this case that its future projected pension and OPEB expenses, absent the proposed true-up mechanism, will have a significant impact on UWNJ's overall financial condition, or could jeopardize the financial well-being of the Company.

10 Response to RCR-A-81
11 Response to RCR-A-51
12 Response to RCR-A-81. Excludes annual fixed TBO amortization.

In summary, I do not believe that UWNJ has met the burden of proof that there is a true and legitimate need for the extraordinary remedy sought by it in this case through the proposed true-up mechanism.

Q. DOES THE PROPOSED DEFERRAL AND RECONCILIATION MECHANISM PROVIDE THE PROPER INCENTIVE FOR UWNJ TO RUN ITS PENSION AND OPEB PLANS AT THE LOWEST POSSIBLE COST?

A. No, it does not. Under current traditional ratemaking, UWNJ management has an incentive to make efficient and economical pension plan and OPEB plan decisions as the Company strives to achieve its rate of return objectives. Based on the current economic climate, many companies are "right-sizing" costs, including pension and OPEB obligations. UWNJ could similarly be motivated to re-evaluate its pension and OPEB obligations. However, this incentive will be lost if the proposed deferral and reconciliation mechanism is implemented. The guaranteed pension and OPEB cost recoveries provided by the proposed true-up mechanism removes or reduces the incentives for the Company to manage its pension and OPEB obligations in the most efficient manner and at the lowest possible cost. If these incentives are removed or reduced through the implementation of the true-up mechanism, it may leave ratepayers to fund unnecessarily high pension and OPEB expenses with a reduced prospect for management attention to pension and OPEB expense containment. Guaranteed cost recovery mechanisms such as the proposed true-up mechanism that diminish the incentive for a utility to efficiently and cost-effectively manage its costs remove some of the ratepayer protections provided under traditional regulation.

E. DISTRIBUTION SYSTEM IMPROVEMENT CHARGE ("DSIC")

Q. PLEASE SUMMARIZE YOUR OVERALL RECOMMENDATION REGARDING THE COMPANY'S PROPOSAL IN THIS CASE TO IMPLEMENT A DISTRIBUTION SYSTEM IMPROVEMENT CHARGE ("DSIC").

A. In this case, UWNJ has proposed a revolutionary new rate mechanism (the DSIC) which would allow the Company to implement a reconcilable surcharge on a quarterly basis to recover the fixed costs (depreciation and pre-tax return on investment) related to certain plant projects completed and placed in service between rate cases that are alleged to be non-revenue producing and non-expense reducing. This novel rate proposal, which is equivalent to a request for an automatic, reconcilable rate increase every quarter, is unprecedented in New Jersey. I recommend that the Company's proposal for this DSIC surcharge mechanism be rejected by the Board for the same reasons as previously stated with regard to the Company's proposed pension/OPEB expense deferral and reconciliation mechanism, namely that the proposed DSIC rate mechanism:

1) represents inappropriate single-issue ratemaking;
2) Is in violation of accepted ratemaking principles and inconsistent with appropriate regulatory policy;
3) Represents a request for extraordinary remedy that is not needed and is unsubstantiated; and
4) Reduces the Company's incentive to manage its infrastructure replacement program in the most efficient manner and at the lowest possible cost.

In addition to the above reasons, the proposed DSIC rate mechanism inappropriately shifts all risks from the stockholders to the ratepayers.

Q. WHY DOES UWNJ'S DSIC PROPOSAL REPRESENT INAPPROPRIATE SINGLE-ISSUE RATEMAKING?

A. I have already provided these reasons in the prior section of this testimony regarding the proposed pension/OPEB rate mechanism, but will repeat these important reasons here. Proper ratemaking requires that all of the components in the ratemaking formula be appropriately "matched." In other words, at the time rates are set or changed, all of the ratemaking components that determine a utility's revenue requirement within a defined test period must be considered and subjected to regulatory review. The proposed DSIC surcharge mechanism violates this matching principle because it would permit UWNJ to change (increase) its rates based on the consideration of two selected ratemaking components[13] that will experience increases without at the same time considering changes in all other ratemaking components, some of which will or may experience decreases. Thus, the proposed DSIC would inappropriately raise rates without regulatory scrutiny of <u>all</u> of UWNJ's revenue requirement components and could result in an achieved return higher than justified if all components of the ratemaking formula were considered. This single-issue ratemaking proposal is inappropriate and should be rejected by the Board.

Furthermore, the proposed implementation of the DSIC will reduce UWNJ's business risk in that the surcharge reduces the risk of regulatory lag and provides UWNJ with a

[13] Depreciation expenses and the return on plant investment.

reconcilable, guaranteed revenue requirement recovery for a major portion of its between-rate case plant additions. This reduction in business risk reduces UWNJ's return on equity requirement, however, UWNJ is not proposing that this cost reduction be recognized in the determination of the DSIC surcharge rate.

Additionally, while UWNJ proposes that the DSIC-eligible plant inclusion will be limited to non-revenue producing, non-expense reducing plant investments, this will be very difficult if not impossible to verify. The matching principle will also be violated to the extent that the DSIC includes plant investments that will generate associated revenue growth and/or cost reductions. The replacement and cleaning and lining of aging distribution mains will have a cost reduction impact on UWNJ's pumping, repair and maintenance, and unaccounted for water expenses. It would be bad regulatory policy not to recognize that these incremental revenues and cost reductions will fully or partially absorb the incremental plant depreciation and return related revenue requirement proposed to be recovered through the DSIC.

Q. WHY IS THE COMPANY'S PROPOSED DSIC RATE MECHANISM IN VIOLATION OF ACCEPTED RATEMAKING PRINCIPLES AND INCONSISTENT WITH APPROPRIATE REGULATORY POLICY?

A. The proposed DSIC rate mechanism is in violation of accepted ratemaking principles and inconsistent with appropriate regulatory policy for the same reasons as previously outlined with regard to the proposed pension/OPEB rate mechanism. It seeks a guaranteed, dollar-for-dollar recovery of capital-related revenue requirements related to certain plant projects that are placed in service between rate cases. One of the most important tenets of ratemaking is that utilities are not guaranteed a return on investment; rather, the ratemaking process entitles the utility no more than a reasonable opportunity to earn a fair rate of return. Regulation is not intended to be a mechanism whereby a utility is guaranteed dollar-for-dollar recovery of either its costs or a particular level of profit and rate of return. This inappropriate kind of regulation is generally referred to as reimbursement ratemaking. Instead, traditional regulation is based on the principle that the utility has an opportunity to earn its rate of return. It is poor regulatory policy to guarantee revenue requirement recovery because the production of safe, adequate and proper utility services at the lowest possible cost requires that a company exert itself and work efficiently; and I believe that the Company will be less likely to do so if it is guaranteed that the consequences of its operating decisions are immune from any cost recovery risks.

By proposing the DSIC rate mechanism, the Company has completely disregarded the foundation upon which the regulatory process was developed, that is, that regulation is supposed to be a substitute for competition. This principal of regulation was designed to stimulate a utility to act as it would if it were in a competitive industry. Clearly, if a utility's rate of return is guaranteed, this represents a departure from traditional ratemaking foundations. Competitive entities do not have any such return guarantees. Regulation is intended to take the place of competition, therefore, regulated entities should not receive guaranteed recovery of their revenue requirement including a guaranteed rate of return if such guarantees are not available in the competitive marketplace.

Q. HAS THE COMPANY SUBSTANTIATED THE NEED FOR THE PROPOSED DSIC RATE MECHANISM?

A. No. The proposed DSIC rate mechanism is essentially a request by UWNJ for extraordinary rate relief. From a regulatory policy standpoint, the impact of an adjustment clause established in the context of a general rate case - where the base rates are set on traditional principles of ratemaking - is to declare that the general rates established in the case cannot in and of themselves be fair, just and reasonable because the revenue requirement covered by the clause cannot be accommodated within the traditional ratemaking process. Typically, the use of reconcilable surcharges or adjustment clauses to provide a utility with extraordinary rate relief had been limited to costs of service that have a significant financial impact. Other factors that are sometimes considered are whether the costs of service are outside the control of management, and exhibit extreme volatility and unpredictability. In addition, such surcharges generally do not provide rate recovery for capital costs, including guaranteed recovery for the return on plant in service additions. These are the properties that underlie the most commonly utilized adjustment clauses such as fuel adjustment clauses and gas cost recovery clauses. Rate recovery through an automatic rate adjustment mechanism should continue to be allowed only when warranted by conditions that could jeopardize the financial well-being of the utility.

UWNJ's proposed DSIC rate mechanism does not meet these requirements. The Company has not provided evidence that the infrastructure replacement and rehabilitation related plant additions to be included for recovery in the DSIC have a significant financial impact on UWNJ and its parent, United Water Resources. Moreover, the Company has not proven that the plant additions are particularly volatile and unpredictable or that the DSIC-eligible plant additions are outside the control of management.

In summary, there is no substantiation for the claims made by UWNJ in support of the proposed DSIC rate mechanism and UWNJ has not met the burden of proof that there is a true and legitimate need for the extraordinary remedy sought by it in this case through the proposed surcharge. The ratepayers should not now be called upon to provide a bail-out fund for UWNJ's management in the form of the proposed DSIC surcharge mechanism.

Q. DOES THE PROPOSED DSIC RATE MECHANISM PROVIDE THE PROPER INCENTIVE FOR NJAWC TO RUN ITS OPERATIONS AT THE LOWEST POSSIBLE COST?

A. No, it does not. Similar to the arguments previously outlined with regard to the proposed pension/OPEB rate mechanism, under current traditional ratemaking, UWNJ management has an incentive to make infrastructure investments in ways that are efficient and economical as the Company strives to achieve its rate of return objectives. This incentive will be lost if the DSIC rate mechanism is implemented. The guaranteed revenue requirement recovery provided by the proposed DSIC removes or reduces the incentives for the Company to manage its infrastructure replacement and rehabilitation programs in the most efficient manner and at the lowest possible cost. If these incentives are removed or reduced through the implementation of the DSIC, it may leave ratepayers to fund unnecessarily high DSIC-eligible capital expenditures with a reduced prospect for management attention to cost containment.

Q. DO YOU HAVE ANY OTHER COMMENTS REGARDING THE COMPANY'S PROPOSED DSIC RATE MECHANISM?

A. Yes. I believe that the primary beneficiaries of the proposed DSIC are UWNJ's shareholders as this proposed surcharge mechanism reduces any potential earnings erosion that may occur between base rate cases and provides the Company's shareholders with a guaranteed, dollar-for-dollar rate of return equal to the Company's most recent Board-authorized rate of return. Thus, while the Company claims that the proposed DSIC is of benefit to the ratepayers, the mechanism focuses predominantly on the interests of UWNJ and its shareholders and inappropriately shifts virtually all risks from the shareholders to the ratepayers.

E. ENERGY AND CHEMICAL COST ADJUSTMENT CLAUSE ("ECCA")

Q. PLEASE DESCRIBE THE ENERGY AND CHEMICAL COST ADJUSTMENT CLUASE THE COMPANY HAS PROPOSED IN THIS CASE.

A. UWNJ has proposed a deferral and reconciliation mechanism that would allow the true-up of the Company's actual annual energy and chemical expenses to the annual energy and chemical expense levels recovered in rates. The proposed deferral and reconciliation mechanism is addressed on pages 13 – 17 of the testimony of UWNJ witness Jim Cagle and will operate in the following way:

1) The current base rate case will establish a revenue level sufficient to recover the level of energy and chemical expenses included by UWNJ in its proposed pro forma test year operating expenses;
2) Any difference between the Company's actual annual energy and chemical and the energy and chemical expenses included in base rates to be established in this case will be deferred;
3) In the next and all subsequent UWNJ rate cases, the deferred energy/chemical cost balances (which could be either net under-recovery or net over-recovery balances) would be amortized to the ratepayers over BPU-approved amortization periods.

The main reasons why the Company has proposed this rate adjustment mechanism is that it believes that its energy and chemical costs have exhibited "extraordinary volatility" and that its energy and chemical cost increases are "uncontrollable."

Q. WHAT IS YOUR POSITION WITH REGARD TO THIS PROPOSED ADJUSTMENT CLAUSE?

A. I recommend that this proposed adjustment clause be rejected by the Board. Similar to the Company's proposed pension/OPEB deferral and reconciliation mechanism and the DSIC clause, the proposed ECCA represents inappropriate single issue ratemaking; is in violation of accepted ratemaking principles and inconsistent with appropriate regulatory policy; and reduces the Company's incentive to run its energy and chemical purchase program in the most efficient manner and at the lowest possible cost. All of these reasons have been described in detail in the previous testimony sections regarding the pension/OPEB deferral and reconciliation mechanism and the DSIC clause and are equally applicable to the proposed ECCA clause.

Q. ARE THERE ANY OTHER REASONS WHY THE COMPANY'S PROPOSED ECCA CLAUSE SHOULD BE REJECTED BY THE BOARD?

A. Yes. First, with regard to the energy portion of the ECCA, it should be noted that the Board has a policy to promote competition in the electric utility industry. The proposed ECCA clause would appear to be inconsistent with this policy. There is a dichotomy between the competitive electric market, which is intended to increase efficiency and provide incentives for buyers to become smart shoppers, and a proposed rate mechanism that permits a buyer to simply pass through to ratepayers their actual purchased energy costs on a guaranteed, dollar-for-dollar basis.

Second, through the ECCA, UWNJ is requesting guaranteed, dollar-for-dollar recovery of expense items (energy and chemical costs) that are not a direct input for the water service being offered to retail customers. If the ECCA is approved for UWNJ, a water utility, then a new precedent will have been established that will encourage UWNJ and other utilities in New Jersey to seek guaranteed, dollar-for-dollar rate recovery of all costs through flow-through adjustment clauses.

Third, the fact that a cost of service item is uncertain or volatile does not justify flowing the cost through to ratepayers on a guaranteed and automatic basis. Management is responsible for planning and anticipating the cost of providing utility service, setting appropriate budgets, and obtaining rate relief through the traditional regulatory process, if and when warranted. Management of UWNJ should continue to be held accountable for these tasks.

Fourth, while the Company claims that its energy and chemical costs are extraordinarily volatile, it appears that these costs are not as volatile at suggested by UWNJ. To prove this point, I have listed the Company' actual combined energy and chemical costs incurred during the last 5 years, from 2005 through 2009:

	Actual Energy and Chemical Costs[14]
2005	$13,559,558
2006	$12,333,792
2007	$15,042,580
2008	$16,483,373
2009	$15,777,597

The data in the above table indicate that the Company's combined energy and chemical expenses during the most recent 5 years averaged approximately $14.6 million. The actual annual energy and chemical expenses during each of the 5 years do not exhibit extraordinary deviations from this average.

Fifth, while the Company claims that its energy and chemical cost increases are "uncontrollable," I do not agree with that claim. The Company's energy and chemical costs should very much be a function of decisions made by management with regard to its energy and chemical purchase program, i.e., management certainly exercises a significant level of control over its energy and chemical costs and cost increases.

[14] See responses to RCR-ECCA-1 and RCR-ECCA-2.

Q. MR. HENKES, DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

SCHEDULES

UNITED WATER NEW JERSEY
REVENUE REQUIREMENT

	UWNJ (1)	Adjustments	RC	
1. Pro Forma Rate Base	$ 643,571,254	$ (103,678,056)	$ 539,893,198	RJH-3
2. Rate of Return	8.62%		7.35%	RJH-2
3. Income Requirement	55,475,842		39,673,965	
4. Pro Forma Income	34,474,806	4,619,435	39,094,241	RJH-9
5. Income Deficiency	21,001,036		579,724	
6. Revenue Conversion Factor	1.8008305		1.8008305	
7. Rate Increase	$ 37,819,306	$ (36,775,321)	$ 1,043,985	
8. % Rate Increase	21.3%		0.6%	

(1) Exhibit P-4

UNITED WATER NEW JERSEY
OVERALL RATE OF RETURN

UWNJ PROPOSAL:

	Ratios	Cost Rates	Weighted Cost Rates
	(1)	(1)	(1)
Long Term Debt	44.41%	5.64%	2.50%
Short Term Debt	0.00%	0.00%	0.00%
Preferred Stock	1.24%	4.70%	0.06%
Common Equity	54.35%	11.15%	6.06%
Total Cost of Capital	100.00%		8.62%

RC RECOMMENDATION:

	Ratios	Cost Rates	Weighted Cost Rates
	(2)	(2)	(2)
Long Term Debt	41.52%	5.57%	2.31%
Short Term Debt	9.45%	2.00%	0.19%
Preferred Stock	1.06%	4.70%	0.05%
Common Equity	47.97%	10.00%	4.80%
Total Cost of Capital	100.00%		7.35%

(1) Exhibit P-8, Schedule PMA-1, page 1
(2) Testimony of Matt Kahal, Schedule MIK-1, page 2

UNITED WATER NEW JERSEY
RATE BASE

	UWNJ (1)	Adjustments	RC	
1. Utility Plant in Service	$ 938,273,452	$ (42,110,712)	$ 896,162,740	RJH-4
2. Accumulated Depreciation	(190,229,670)	7,898,736	(182,330,934)	RJH-5
3. Contributions in Aid of Construction	(32,180,451)	(1,031,408)	(33,211,859)	(2)
4. Customer Advances for Construction	(11,661,237)	(689,933)	(12,351,170)	(2)
5. Accumulated Deferred Income Taxes	(89,857,267)	(3,533,147)	(93,390,414)	RJH-6
6. Materials and Supplies	2,742,684	(39,104)	2,703,580	(3)
7. Prepaid Expenses	1,696,439	200,492	1,896,931	(4)
8. Working Capital	15,814,480	(2,793,297)	13,021,183	RJH-7
9. Customer Deposits	(230,571)	(65,036)	(295,607)	(2)
10. Unamortized Debt Expense	9,203,394	270,418	9,473,812	(5)
11. I&D Reserve Balance	-	(1,279,948)	(1,279,948)	(6)
12. Consolidated Income Tax Benefits	-	(60,505,116)	(60,505,116)	RJH-8
13. TOTAL NET RATE BASE	$ 643,571,253	$ (103,678,055)	$ 539,893,198	

(1) Exhibit P-4, Schedule 8
(2) Actual balances as of 1/31/10
(3) 13-month average balance for test year - per response to RCR-A-19
(4) 13-month average balance for test year - per response to RCR-A-20
(5) Actual 1/31/10 balance of $14,575,095, net of associated ADIT @ 35% = net balance of $9,473,812
(6) 13-mos. avg. balance for test year ended 1/31/10 = $1,969,151 (RCR-A-21) less associated ADIT @35% = net $1,279,948

UNITED WATER NEW JERSEY
RECOMMENDED PLANT IN SERVICE

1. Actual Plant in Service Balance as of January 31, 2010	$ 889,971,140	
Post-Test Year Additions from 2/1/10 - 7/31/10:		
2. Haworth Project	5,305,200	(1)
3. Other Major Projects	886,400	(1)
4. Total Post-Test Year Additions	6,191,600	
5. Recommended Pro Forma Plant In Service Balance	$ 896,162,740	

(1) Testimony of Howard Woods, Schedule HJW-6

UNITED WATER NEW JERSEY
RECOMMENDED ACCUMULATED DEPRECIATION RESERVE

1. Actual Depreciation Reserve Balance as of January 31, 2010	$ 181,277,485	
Post-Test Year Additions from 1/31/10 - 7/31/10		
2. Projected Haworth Plant Related Retirements	-	(1)
3. Projected Haworth Related Cost of Removal	-	(1)
4. Difference Between Recommended Annualized Depreciation and Actual Test Year Depreciation	1,053,449	(2)
5. Recommended Pro Forma Depreciation Reserve Balance	$ 182,330,934	

(1) Response to RCR-A-140

(2) Recommended annualized depreciation expense	$ 19,885,679	Sch. RJH-23, L3
Actual test year depreciation expense included in 1/31/10 reserve balance	18,832,230	
Recommended incremental depreciation expenses	$ 1,053,449	

UNITED WATER NEW JERSEY
RECOMMENDED ACCUMULATED DEFERRED INCOME TAX BALANCE

1.	Actual Deferred Income Tax Rate Base Deduction Balance @ 1/31/10 According to UWNJ's Proposed Approach	$ 90,844,805	(1)
2.	Additional Deferred Income Tax Rate Base Deduction @ 1/31/10 for AFUDC Equity as Conceded by UWNJ in Response to RCR-A-17	2,545,609	
3.	Total Recommended Deferred Income Tax Rate Base Deduction	$ 93,390,414	

(1) Response to RCR-A-16

Docket No. WR09120987 Sch. RJH-7
Test Year Ending 1/31/10

UNITED WATER NEW JERSEY
CASH WORKING CAPITAL

1.	CWC Proposed by UWNJ	$ 15,814,480	P-7, Schedule 1
	<u>Recommended Adjustments</u>:		
2.	Remove CWC Impact of UWNJ's Proposed Rate Increase	(1,571,843)	(1)
3.	Add CWC Impact of RC's Proposed Rate Decrease	-	(2)
4.	Remove CWC Impact of Capitalized Health Insurance	(124,510)	(3)
5.	Remove CWC Impact of Capitalized Payroll Taxes	(160,239)	(4)
6.	CWC Reduction due to Lag in LT Interest	(936,705)	(5)
7.	RC's Recommended CWC	$ 13,021,183	

(1)	Calculation per response to RCR-A-24(e): ($11,308,250 / 365) x 28 =		$ 867,482	
	Calculation per response to RCR-A-24(f): ($5,246,767 / 365) x 49 =		704,361	
	Total CWC impact		$ 1,571,843	
(2)	Rate decrease should have no impact on UWNJ's cash working capital requirement			
(3)	Calculation per response to RCR-A-24(b): [($1,823,408 x 48.87%) / 365] x 51 = $124,510			
(4)	Calculation per response to RCR-A-24(c): [($2,346,655 x 48.87%) / 365] x 51 = $160,239			
(5)	UWNJ pro forma LT debt interest		$ 16,089,281	RJH-24 , L2
			365	
	Average Daily interest		44,080	
	Revenue collection days	70.00		
	Interest payment lag: 365 / 4 =	(91.25)		
			(21.25)	
	Impact on CWC		$ (936,705)	

Docket No. WR09120987
Test Year Ending 1/31/10

Sch. RJH-8

UNITED WATER NEW JERSEY
CONSOLIDATED INCOME TAX RATE BASE ADJUSTMENT

	CIT Benefits Per "RECO Method" Calculated by UWNJ	CIT Benefits Alternative Method Calculated by UWNJ	
	(1)	(2)	
1991	$ 3,355	$ 3,355	
1992	-	-	
1993	-	-	
1994	-	-	
1995	-	-	
1996	-	-	
1997	596,079	596,079	
1998	520,058	520,058	
1999	-	-	
2000	7,022,925	982,621	*
2001	6,382,133	5,934,002	*
2002	-	-	
2003	13,855,611	6,330,683	*
2004	12,562,940	2,565,567	*
2005	4,968,588	4,968,588	
2006	4,143,689	4,143,689	
2007	3,245,520	3,245,520	
2008	7,204,218	7,204,218	
Total	$ 60,505,116	$ 36,491,025	

* In these tax years, the CIT benefit amount calculated under the "RECO method" exceeded the income tax amount calculated for UWNJ on a stand-alone basis and the CIT benefit amount shown has been limited to the income tax amount calculated for UWNJ on a stand-alone basis.

(1) Per response to RCR-A-32 where UWNJ calculated the annual CIT benefits based on the RECO method.
(2) Per response to RCR-A-32 where UWNJ calculated the annual CIT benefits based on the RECO method, but adjusted by limiting the CIT benefit amounts in any given year to the amount of income tax calculated for UWNJ on a stand-alone basis

UNITED WATER NEW JERSEY
OPERATING INCOME

	UWNJ (1)	Adjustments		RC	
1. Operating Revenues:					
a. Unmetered Sales	$ 70,356			$ 70,356	
b. Metered Sales	150,682,905	(626,983)		150,055,922	(2)
c. Private Fire Protection	14,067,316	(146,153)		13,921,163	(2)
d. Public Fire Protection	8,180,635	(16,256)		8,164,379	(2)
e. Sales for Resale	4,200,882			4,200,882	
f. Intercompany Sales	5,724			5,724	
g. Other Operating Revenues	385,112			385,112	
h. Total Operating Revenues	177,592,930	(789,392)		176,803,538	
Operating Expenses:					
2. Operation & Maintenance Expenses	79,631,864	(7,970,324)		71,661,540	RJH-10
3. Depreciation Expense	20,900,025	(1,014,346)		19,885,679	RJH-23
4. Amortization Expense	-	-		-	
5. Revenue Taxes	24,363,934	(109,516)	(3)	24,254,418	
6. Property Taxes	5,557,089	(64,220)		5,492,869	(4)
7. Payroll Taxes	2,346,655	(128,636)	(5)	2,218,019	
8. Other Taxes	403,215			403,215	
9. Operating Expenses Before Inc. Tax	133,202,782	(9,287,043)		123,915,739	
10. Operating Income Before Income Tax	44,390,148	8,497,651		52,887,799	
11. Income Taxes	9,915,341	3,878,216		13,793,558	RJH-24
12. Operating Income	$ 34,474,807	$ 4,619,434		$ 39,094,241	

(1) Exhibit P-4 and Exhibit P-4, Schedules 1, 4 and 5.
(2) Adjusted revenues for the test year ended 1/31/10 - per Exhibit P-4, Schedule 1
(3) 13.735% x operating revenue adjustment line 1h
(4) Response to RCR-A-26(d)
(5) Labor expense adjustment on Schedule RJH-10, line 1 x payroll tax ratio of approximately 8%

Docket No. WR09120987
Test Year Ending 1/31/10

Sch. RJH-10

UNITED WATER NEW JERSEY
OPERATION AND MAINTENANCE EXPENSE SUMMARY

	UWNJ (1)	Adjustments		RC	
1. Labor Expenses	$ 15,913,963	$ (1,607,954)		$ 14,306,009	RJH-11
2. Purchased Water	6,808,156	(796,827)		6,011,329	(2)
3. Power Purchased for Pumping	12,501,824	(156,720)	(3)	12,345,104	
4. Chemical Expense	4,733,086	(228,586)		4,504,500	(4)
5. Waste Residuals (Sludge)	3,692,592	(1,257,388)		2,435,204	RJH-12
6. Tank Painting	399,753	(60,000)		339,753	RJH-13
7. Transportation Expense	2,037,630	(151,192)		1,886,438	RJH-14
8. Uncollectible Accounts	875,126	(3,898)	(5)	871,228	
9. Customer Information Systems Exp.	1,448,797			1,448,797	
10. Outside Services Employed	2,489,002	(140,704)		2,348,298	RJH-15
11. Property and Liability Insurance	2,356,775	(94,800)		2,261,975	RJH-16
12. Injuries and Damages	981,439	(62,439)		919,000	(6)
13. Employee Pensions and Benefits	11,970,541	(3,162,925)		8,807,616	RJH-17
14. Regulatory Commission Expenses	646,853	(224,979)		421,874	RJH-18
15. Rent/Lease Expense	813,071			813,071	
16. Management and Service Fees	9,800,501	(1,632,202)		8,168,299	RJH-19
17. Fringe Benefit/G&A Exp. Transfers	(10,003,120)	932,873		(9,070,247)	RJH-20
18. Other O&M Expenses	12,165,875	1,896,181		14,062,056	(7)
19. Miscellaneous Expense Adjustments	-	(1,036,394)		(1,036,394)	RJH-21
20. Expense Decrease Associated With Revenue Adjustment	-	(111,283)		(111,283)	RJH-22
21. MBTE Amortization	-	(71,088)		(71,088)	(8)
22. Total Pro Forma O&M Expenses	$ 79,631,864	$ (7,970,324)		$ 71,661,540	

(1) Exhibit P-4, Schedule 2
(2) Response to RCR-A-126
(3)

	Fixed PPL Lease	
UWNJ's reflected 2010 incorrect budget	$ 1,597,200	Exh. P-4, Schedule 2-C, L9
RC's reflected 2010 correct budget	1,440,480	Response to RCR-A-91
Fixed PPL lease fee adjustment	$ (156,720)	

(4) Testimony of Howard Woods
(5) Uncollectible ratio of .4938% x revenue adjustment on Schedule RJH-9, line 1(h)
(6) Based on 2010 budget
(7) Based on corrected 3-yr average Other O&M expenses for 2007, 2008 and the test year ended 1/31/10 (RCR-A-51a Updated)
(8) Response to RCR-A-14

UNITED WATER NEW JERSEY
LABOR EXPENSES

	UWNJ (1)	Adjustments	RC	
1. Salary and Wages	$ 23,922,507		$ 23,922,507	
2. New Position 2010	67,538		67,538	
3. Salary & Wage Increases	757,778		757,778	
4. Overtime Expense	3,955,775	(1,147,333)	2,808,442	(2)
5. Standby/Substitution Pay	208,642		208,642	
6. Incentive Compensation	1,338,846	(1,338,846)	-	
7. Sub-Total	30,251,086	(2,486,179)	27,764,907	
8. Summer Help	223,230		223,230	
9. Labor Transferred In	224,065	(84,822)	139,243	(3)
10. Labor Transferred Out (L7 x 48.87235%)	(14,784,417)	963,046	(13,821,371)	(4)
11. Total Net Labor Expense	$ 15,913,963	$ (1,607,955)	$ 14,306,009	

(1) Exhibit P-4, Schedule 2-A

(2) UWNJ based on average overtime expense for 2007, 2008 and yr. ended 6/30/09. RC based on overtime expense included in the 2010 budget, similar to what UWNJ has proposed for summer help and standby/substitution pay expenses (RCR-A-58)

(3) Per SIR-22, p. 6 and response to RCR-A-55:

	Labor Transferred In
2007	$ 350,941
2008	35,306
test year ended 1/31/10	31,482
3-year average	$ 139,243

(4)

Actual Labor Out Transfer Ratios:

	RC	
2007	49.72%	SIR-22, p.7
2008	52.08%	SIR-22, p.7
test year ended 1/31/10	47.54%	RCR-A-55
3-year average ratio	49.78%	
sub-total labor costs on line 7	$ 27,764,907	
Labor Transferred Out	$ (13,821,371)	

UNITED WATER NEW JERSEY
WASTE RESIDUAL EXPENSES

	UWNJ (1)	Adjustments	RC	
1. Amortization of Lagoon 3 Sludge Removal	$ 352,000	$ (26,796)	$ 325,204	(2)
2. Residuals Management Expense	2,485,319	(735,319)	1,750,000	(3)
3. BCUA Charges	855,273	(495,273)	360,000	(4)
4. Total Waste Residual Expense	$ 3,692,592	$ (1,257,388)	$ 2,435,204	

(1) Exhibit P-4, Schedule 2-E
(2) Per response to RCR-A-89(b): total estimated cost of $975,613 amortized over 3 years = $325,204
(3) Calculation: actual 2009 of $1,607,039 vs. budget 2009 of $2,448,930 (RCR-A-88) = 65.62% x $2,485,319 (SIR-26) = $1,630,866. Increased to $1,750,000 to be conservative.
(4) Response to RCR-A-128(a)

Docket No. WR09120987
Test Year Ending 1/31/10

Sch. RJH-13

UNITED WATER NEW JERSEY
TANK PAINTING EXPENSES

	UWNJ (1)	Adjustments	RC	
1. Backwash Tank #1	$ 60,000	$ (30,000)	$ 30,000	(2)
2. Backwash Tank #2	35,000	(17,500)	17,500	(2)
3. Timberline Tank	25,000	(12,500)	12,500	(2)
4. Ridgefield Reservoir #1	100,000		100,000	
5. Music Mountain GS Tank	39,000		39,000	
6. Ridgefield Reservoir #2	100,000		100,000	
7. Frankline Lakes Tank	4,273		4,273	
8. Woodcrest Dev GS Tank	3,980		3,980	
9. Highland Lakes Season Tank	14,000		14,000	
10. Hamton Ground Storage	7,000		7,000	
11. Hampton Sphere	11,500		11,500	
12. Total Tank Painting	$ 399,753	$ (60,000)	$ 339,753	

(1) Exhibit P-4, Schedule 2-F
(2) UWNJ's amortization is based on 10-year amortization. RC's amortization is based on 20-year amortization

Docket No. WR09120987
Test Year Ending 1/31/10

Sch. RJH-14

UNITED WATER NEW JERSEY
TRANSPORTATION EXPENSES

	UWNJ (1)	Adjustments	RC	
1. Fuel	$ 647,006	$ (80,790)	$ 566,216	(2)
2. Leases	1,620,466		1,620,466	
3. Maintenance & Repair	511,741	(1,837)	509,904	(2)
4. Payroll	907,533	(74,586)	832,947	(3)
5. Insurance	147,770	(39,905)	107,865	(2)
6. Depreciation	28,575		28,575	
7. Other	122,286	(31,911)	90,375	(2)
8. Total Expenses Prior to Capitalization	3,985,377	(229,029)	3,756,348	
9. Capitalization Ratio	48.87%		49.78%	(4)
10. Capitalized Transportation Cost	(1,947,748)	77,838	(1,869,910)	
11. Transportation O&M Expense	$ 2,037,630	$ (151,191)	$ 1,886,438	

(1) Exhibit P-4, Schedule 2-G
(2) Average of 2007, 2008 and test year ended 1/31/10 - per SIR-28-A and response to RCR-A-77
(3) 3% x payroll amount on Schedule RJH-11, line 7
(4) Schedule RJH-11, footnote (4)

UNITED WATER NEW JERSEY
OUTSIDE SERVICES EMPLOYED

	UWNJ (1)	Adjustments	RC	
1. Outside Services Employed:				
a. Accounting & Auditing	$ 121,600		$ 121,600	
b. Legal	288,400		288,400	
c. Information Systems	731,260		731,260	
d. Temporary Help	21,200		21,200	
e. R&I Alliance	736,109		736,109	
f. Other	590,434	(140,705)	449,729	(2)
g. Total	$ 2,489,003	$ (140,705)	$ 2,348,298	

(1) Exhibit P-4, Schedule 2-J
(2) Based on average of actual other expenses per response to RCR-A-84:

2007	$ 434,612
2008	426,746
test year 1/31/10	487,829
	$ 449,729

UNITED WATER NEW JERSEY
INSURANCE OTHER THAN GROUP EXPENSES

	UWNJ (1)	Adjustments	RC	
1. Property Insurance	$ 192,588	$ -	$ 192,588	
2. General Liability Insurance	2,164,187	(94,800)	2,069,387	(2)
3. Total Insurance Other Than Group	$ 2,356,775	$ (94,800)	$ 2,261,975	

(1) Exhibit P-4, Schedule 2-K
(2) Response to RCR-A-120

UNITED WATER NEW JERSEY
EMPLOYEE PENSIONS AND BENEFITS

	UWNJ (1)	Adjustments	RC (2)	
1. Medical/Dental/Vision/Group Life	$ 2,993,211		$ 2,993,211	
2. 401(k) Matching	573,172		573,172	
3. Pension	3,918,105	(1,816,159) (2)	2,101,946	
4. OPEB	3,003,709		3,003,709	
5. Other Benefits	258,972	(123,394)	135,578	(3)
6. Sub-Total	10,747,169	(1,939,553)	8,807,616	
7. Amortization of Deferred 2009 Pension Exp.	1,223,372	(1,223,372)	-	(4)
8. Total Employee Pensions and Benefits	$ 11,970,541	$ (3,162,925)	$ 8,807,616	

(1) Exhibit P-4, Schedule 2-M

(2) Testimony of Mitch Serota: recommended reduction of $7,655,970 to total 2009 UWR, Inc. pension costs of $16,516,573 results in adjustment percentage of (46.353%) x $3,918,105 = ($1,816,159) for UWNJ pension cost adjustment.

(3) Response to RCR-A-125

(4) Testimony of Robert Henkes

Docket No. WR09120987
Test Year Ending 1/31/10

Sch. RJH-18

UNITED WATER NEW JERSEY
REGULATORY COMMISSION EXPENSES

	UWNJ	Adjustments	RC	
Rate Case Expenses:	(1)			
1. UWM&S Charges	$ 275,000	$ (275,000)	$ -	
2. Legal Services	500,000	(200,000)	300,000	
3. Rate of Return Consultant	25,000		25,000	
4. Cust. Notification, Transcripts, Misc.	30,000		30,000	
5. Consulting Services	35,000		35,000	
9. Total Rate Case Expenses	865,000	(475,000)	390,000	
10. 50% Stockholder Sharing	-		(195,000)	
11. Expense Chargeable to Ratepayers	865,000		195,000	
12. Amortization Period (Yrs)	3		3	
13. Annual Rate Case Expense	288,333	(223,333)	65,000	
BPU and RC Assessments:				
14. BPU Assessments	302,960	(1,392)	301,568	(2)
15. RC Assessments	55,559	(253)	55,306	(2)
16. Total Assessments	358,519	(1,645)	356,874	
Total Regulatory Expenses [Lines 13 + 16]	$ 646,853	$ (224,979)	$ 421,874	

(1) Exhibit P-4, Schedule 2-N

(2)

	UWNJ	RC	
Taxable Revenues	$ 177,225,569	$ 176,418,426	RJH-9, L1h-L1g
BPU Assessment Rate	0.001709393	0.001709393	
BPU Assessments	$ 302,960	$ 301,568	
Taxable Revenues	$ 177,225,569	$ 176,418,426	RJH-9, L1h-L1g
RC Assessment Rate	0.000313493	0.000313493	
RC Assessments	$ 55,559	$ 55,306	

UNITED WATER NEW JERSEY
RECOMMENDED MANAGEMENT AND SERVICE FEES

1.	Total UWM&S Fees Proposed by UWNJ	$ 9,800,501	(1)
2.	Initial Rate Counsel Adjustment	(416,305)	
3.	Total UWM&S Fees Recommended by Rate Counsel (95.75% of L1)	9,384,196	(2)
	Additional Recommended Adjustments:		
4.	Remove Incentive Compensation	(869,207)	(3)
5.	Remove Public and Community Relations Expenses	(283,239)	(4)
6.	Remove Lobbying Expenses	(45,378)	(5)
7.	Remove SERP Costs	(18,073)	(6)
8.	Recommended Adjusted UWM&S Fees	$ 8,168,299	

(1) Exhibit P-4, Schedule 2-P

(2) Per response to RCR-A-63:

Budgeted UWM&S fees in 2009 (proposed by UWNJ)	$	9,800,501
Actual UWM&S fees in 2009		8,893,287
Ratio actual to budget		90.74%
Budgeted UWM&S fees in 2010		10,341,488
Pro forma fees recommended by Rate Counsel	$	9,384,196

(3) Response to RCR-A-64(a): $907,788 x 95.75% = $869,207

(4) Response to RCR-A-64(d): $312,143 x 95.75% = $298,877

(5) Response to RCR-A-65: $47,392 x 95.75% = $45,378

(6) Response to RCR-A-64(e): $18,875 x 95.75% = $18,073

UNITED WATER NEW JERSEY
EXPENSE TRANSFERS

	UWNJ (1)	Adjustments	RC	
1. Fringe Benefits:				
a. Payroll Taxes	$ 2,346,655	$ (128,636)	$ 2,218,019	RJH-9, L7
b. Employee Benefits	10,747,169	(1,939,553)	8,807,616	RJH-17, L6
c. Workers Comp	981,439	(62,439)	919,000	RJH-10, L12
d. Total Fringe Benefits	14,075,263	(2,130,628)	11,944,635	
2. Fringe Benefit Transfer Ratio	-48.87%		-49.78%	(2)
3. Fringe Benefits Transferred	(6,878,912)	932,873	(5,946,039)	
4. G&A Expenses Transferred	(3,124,208)		(3,124,208)	
5. Total Expense Transfers	$ (10,003,120)	$ 932,873	$ (9,070,247)	

(1) Exhibit P-4, Schedule 2-Q and SIR-38
(2) Schedule RJH-11, footnote (4)

Docket No. WR09120987
Test Year Ending 1/31/10

Sch. RJH-21

UNITED WATER NEW JERSEY
MISCELLANEOUS EXPENSE ADJUSTMENTS

1.	Remove Charitable Contributions	$ (265,000)	RCR-A-95(a)
2.	Remove Lobbying Expenses	(150,000)	RCR-A-95(b)
3.	Remove Gifts/Awards/Service Recognition Dinners	(90,000)	RCR-A-95(e)
4.	Remove Lobbying Portion NAWC Dues	(17,748)	RCR-A-95(i) and 48: $104,400 x 17%
5.	Remove Lobbying Portion NJUA Dues	(6,300)	RCR-A-95(i) and 48: $45,000 x 14%
6.	Remove Various Public Relations Expenses	(11,800)	(1)
7.	Remove Certain Membership Dues	(95,200)	(2)
8.	3-Year Amortization of Gain on Sale of Property	(117,142)	(3)
9.	Remove Various Account 930 Expense Items	(283,204)	(4)
10.	Total Miscellaneous Expense Adjustments	$ (1,036,394)	

(1) Per RCR-A-95(c) and RCR-A-136: Senior Day - $1,800; National Drinking Water Week - $10,000

(2) Per RCR-A-95(j) and RCR-A-135: Foundation Room - $8,500; Forest Hills Field Club - $25,000; Annual Football Classic - $5,000; Bergen 200 Club - $1,000; Sierra Club - $5,000; Foundation of Free Enterprise - $17,000; Volunteer; NJ Conf of Mayors - $10,000 Volunteer Center of Bergen County - $2,000; Rotaries - $270; and miscellaneous corporate contributions - $1,930 and $19,500

(3) Per response to RCR-A-97:

- Net pre-tax gain on sales of 2 properties	$ 702,853
- 50% share allocated to ratepayers	351,427
- 3-year amortization of 50% share	$ 117,142

(4) Per reponse to RCR-A-137: removed all items designated as "image building" expense (a); donations (d); and non-recurring (e)
Note: any double-counts included in this adjustment when compared to the adjustments made on lines 1-7 must be eliminated.

UNITED WATER NEW JERSEY
EXPENSE DECREASE ASSOCIATED WITH REVENUE ADJUSTMENT

1.	Recommended Purchased Water Expenses	$	6,011,329	RJH-10, L2
2.	Recommended Power Expenses		12,345,104	RJH-10, L3
3.	Recommended Chemical Expenses		4,504,500	RJH-10, L4
4.	Recommended Wast Disposal Expenses		2,435,204	RJH-10, L5
5.	Total Expenses	$	25,296,137	
6.	Recommended Normalized Metered Sales		40,144,889	Exh. P-4, Schedule 1A
7.	Expense per Sales Unit	$	0.630	
8.	Recommended Normalized Metered Sales		40,144,889	
9.	UWNJ's Proposed Normalized Metered Sales		40,321,494	Exh. P-4, Schedule 1A
10.	Increase in Normalized Metered Sales		(176,605)	
11.	Expense Decrease Associated With Decrease in Normalized Sales [L7 x L10]	$	(111,283)	

Docket No. WR09120987
Test Year Ending 1/31/10

Sch. RJH-23

UNITED WATER NEW JERSEY
DEPRECIATION EXPENSE

	UWNJ (1)	Adjustments	RC	
1. Total Plant In Service	$ 938,273,452		$ 896,162,740	RJH-3, L1
2. Less: Non-Depr. Plant	(33,015,405)		(33,015,405)	
3. Depreciable Plant	905,258,047		863,147,335	
4. Composite Depr. Rate	2.3630%		2.3630%	
5. Depreciation Expense	21,391,052	(995,067)	20,395,985	
6. CIAC and CAC	(43,841,688)		(45,563,029)	RJH-3, L3+4
7. Composite Depr. Rate	1.1200%		1.1200%	
8. Depreciation Exp. Credit	(491,027)	(19,279)	(510,306)	
9. Net Depreciation Expense	$ 20,900,025	$ (1,014,346)	$ 19,885,679	

(1) SIR-41

UNITED WATER NEW JERSEY
INCOME TAXES

	UWNJ (1)	Adjustments	RC	
1. Operating Income Before Income Tax	$ 44,390,148		$ 52,887,799	RJH-9, L9
2. Pro Forma Interest Deduction	(16,089,281)		(13,506,314)	(2)
3. Federal Taxable Income	28,300,867		39,381,485	
4. FIT Rate	35%		35%	
5. Federal Income Taxes	9,905,303		13,783,520	
6. Amortization of Flow-Through Tax	370,950		370,950	
7. Amortization of ITC	(360,912)		(360,912)	
8. Total Net Federal Income Taxes	$ 9,915,341	$ 3,878,216	$ 13,793,558	

(1) Exhibit P-4, Schedule 6

	UWNJ	RC	
(2) Rate Base	$ 643,571,253	$ 539,893,198	RJH-3
Weighted Cost of Debt	2.50%	2.50%	RJH-2
Pro Forma Interest	$ 16,089,281	$ 13,506,314	

APPENDIX I

PRIOR REGULATORY EXPERIENCE OF ROBERT J. HENKES

* = Testimonies prepared and submitted

ARKANSAS

Southwestern Bell Telephone Company Divestiture Base Rate Proceeding*	Docket 83-045-U	09/1983

DELAWARE

Delmarva Power and Light Company Electric Fuel Clause Proceeding	Docket 41-79	04/1980
Delmarva Power and Light Company Electric Fuel Clause Proceeding	Docket 80-39	02/1981
Delmarva Power and Light Company Sale of Power Station Generation	Complaint Docket 279-80	04/1981
Delmarva Power and Light Company Electric Base Rate Proceeding	Docket 81-12	06/1981
Delmarva Power and Light Company Gas Base Rate Proceeding*	Docket 81-13	08/1981
Delmarva Power and Light Company Electric Fuel Clause Proceeding*	Docket 82-45	04/1983
Delmarva Power and Light Company Electric Fuel Clause Proceeding*	Docket 83-26	04/1984
Delmarva Power and Light Company Electric Fuel Clause Proceeding*	Docket 84-30	04/1985
Delmarva Power and Light Company Electric Fuel Clause Proceeding*	Docket 85-26	03/1986
Delmarva Power and Light Company Report of DP&L Operating Earnings*	Docket 86-24	07/1986
Delmarva Power and Light Company Electric Base Rate Proceeding*	Docket 86-24	12/1986 01/1987
Delmarva Power and Light Company Report Re. PROMOD and Its Use in	Docket 85-26	10/1986

Fuel Clause Proceedings*

Diamond State Telephone Company Base Rate Proceeding*	Docket 86-20	04/1987
Delmarva Power and Light Company Electric Fuel Clause Proceeding*	Docket 87-33	06/1988
Delmarva Power and Light Company Electric Fuel Clause Proceeding*	Docket 90-35F	05/1991
Delmarva Power and Light Company Electric Base Rate Proceeding*	Docket 91-20	10/1991
Delmarva Power and Light Company Gas Base Rate Proceeding*	Docket 91-24	04/1992
Artesian Water Company Water Base Rate Proceeding*	Docket 97-66	07/1997
Artesian Water Company Water Base Rate Proceeding*	Docket 97-340	02/1998
United Water Delaware Water Base Rate Proceeding*	Docket 98-98	08/1998
Delmarva Power and Light Company Revenue Requirement and Stranded Cost Reviews	Not Docketed	12/1998
Artesian Water Company Water Base Rate Proceeding*	Docket 99-197 (Direct Test.)	09/1999
Artesian Water Company Water Base Rate Proceeding*	Docket 99-197 (Supplement. Test)	10/1999
Tidewater Utilities/ Public Water Co. Water Base Rate Proceedings*	Docket No. 99-466	03/2000
Delmarva Power & Light Company Competitive Services Margin Sharing Proceeding*	Docket No. 00-314	03/2001
Artesian Water Company Water Base Rate Proceeding*	Docket No. 00-649	04/2001
Chesapeake Gas Company	Docket No. 01-307	12/2001

Gas Base Rate Proceeding*		
Tidewater Utilities Water Base Rate Proceeding*	Docket No. 02-28	07/2002
Artesian Water Company Water Base Rate Proceeding*	Docket No. 02-109	09/2002
Delmarva Power & Light Company Electric Cost of Service Proceeding	Docket No. 02-231	03/2003
Delmarva Power & Light Company Gas Base Rate Proceeding*	Docket No. 03-127	08/2003
Artesian Water Company Water Base Rate Proceeding*	Docket No. 04-42	08/2004
United Water Delaware Water Base Rate Proceeding*	Docket No. 06-174	10/2006
United Water Delaware Water Base Rate Proceeding*	Docket No. 09-60	06/2009

<u>DISTRICT OF COLUMBIA</u>

District of Columbia Natural Gas Co. Gas Base Rate Proceeding*	Formal Case 870	05/1988
District of Columbia Natural Gas Co. Gas Base Rate Proceeding*	Formal Case 890	02/1990
District of Columbia Natural Gas Co. Waiver of Certain GS Provisions	Formal Case 898	08/1990
Chesapeake and Potomac Telephone Co. Base Rate Proceeding*	Formal Case 850	07/1991
Chesapeake and Potomac Telephone Co. Base Rate Proceeding*	Formal Case 926	10/1993
Bell Atlantic - District of Columbia SPF Surcharge Proceeding	Formal Case 926	06/19/94
Bell Atlantic - District of Columbia Price Cap Plan and Earnings Review	Formal Case 814 IV	07/1995

GEORGIA

Southern Bell Telephone Company Base Rate Proceeding	Docket 3465-U	08/1984
Southern Bell Telephone Company Base Rate Proceeding	Docket 3518-U	08/1985
Georgia Power Company Electric Base Rate and Nuclear Power Plant Phase-In Proceeding*	Docket 3673-U	08/1987
Georgia Power Company Electric Base Rate and Nuclear Power Plant Phase-In Proceeding*	Docket 3840-U	08/1989
Southern Bell Telephone Company Base Rate Proceeding	Docket 3905-U	08/1990
Southern Bell Telephone Company Implementation, Administration and Mechanics of Universal Service Fund*	Docket 3921-U	10/1990
Atlanta Gas Light Company Gas Base Rate Proceeding*	Docket 4177-U	08/1992
Southern Bell Telephone Company Report on Cash Working Capital*	Docket 3905-U	03/1993
Atlanta Gas Light Company Gas Base Rate Proceeding*	Docket No. 4451-U	08/1993
Atlanta Gas Light Company Gas Base Rate Proceeding	Docket No. 5116-U	08/1994
Georgia Independent Telephone Companies Earnings Review and Show Cause Proceedings	Various Dockets	1994
Georgia Power Company Earnings Review - Report to GPSC*	Non-Docketed	09/1995
Georgia Alltel Telecommunication Companies Earnings and Rate Reviews	Docket No. 6746-U	07/1996

Frontier Communications of Georgia Earnings and Rate Review	Docket No. 4997-U	07/1996
Georgia Power Company Electric Base Rate / Accounting Order Proceeding	Docket No. 9355-U	12/1998
Savannah Electric Power Company Electric Base Rate Case/Alternative Rate Plan*	Docket No. 14618-U	03/2002
Georgia Power Company Electric Base Rate / Alternative Rate Plan Proceeding*	Docket No. 18300-U	12/2004
Savannah Electric Power Company Electric Base Rate Case/Alternative Rate Plan*	Docket No. 19758-U	03/2005
Georgia Power Company Electric Base Rate Case/Alternative Rate Plan*	Docket No. 25060-U	10/2007

FERC

Philadelphia Electric/Conowingo Power Electric Base Rate Proceeding*	Docket ER 80-557/558	07/1981

KENTUCKY

Kentucky Power Company Electric Base Rate Proceeding*	Case 8429	04/1982
Kentucky Power Company Electric Base Rate Proceeding*	Case 8734	06/1983
Kentucky Power Company Electric Base Rate Proceeding*	Case 9061	09/1984
South Central Bell Telephone Company Base Rate Proceeding*	Case 9160	01/1985
Kentucky-American Water Company Base Rate Proceeding*	Case 97-034	06/1997
Delta Natural Gas Company Base Rate Proceeding*	Case 97-066	07/1997

Kentucky Utilities and LG&E Company Environmental Surcharge Proceeding	97-SC-1091-DG	01/1999
Delta Natural Gas Company Experimental Alternative Regulation Plan*	Case No. 99-046	07/1999
Delta Natural Gas Company Base Rate Proceeding*	Case No. 99-176	09/1999
Louisville Gas & Electric Company Gas Base Rate Proceeding*	Case No. 2000-080	06/2000
Kentucky-American Water Company Base Rate Proceeding*	Case No. 2000-120	07/2000
Jackson Energy Cooperative Corporation Electric Base Rate Proceeding*	Case No. 2000-373	02/2001
Kentucky-American Water Company Base Rate Rehearing*	Case No. 2000-120	02/2001
Kentucky-American Water Company Rehearing Opposition Testimony*	Case No. 2000-120	03/2001
Union Light Heat and Power Company Gas Base Rate Proceeding*	Case No. 2001-092	09/2001
Louisville Gas & Electric Company and Kentucky Utilities Company Deferred Debits Accounting Order	Case No. 2001-169	10/2001
Fleming-Mason Energy Cooperative Electric Base Rate Proceeding	Case No. 2001-244	05/2002
Northern Kentucky Water District Water District Base Rate Proceeding	Case No. 2003-0224	02/2004
Louisville Gas & Electric Company Electric Base Rate Proceeding*	Case No. 2003-0433	03/2004
Louisville Gas & Electric Company Gas Base Rate Proceeding*	Case No. 2003-0433	03/2004
Delta Natural Gas Company Base Rate Proceeding*	Case No. 2004-00067	07/2004

Union Light Heat and Power Company Gas Base Rate Proceeding*	Case No. 2005-00042	06/2005
Big Sandy Rural Electric Cooperative Electric Base Rate Proceeding	Case No. 2005-00125	08/2005
Louisville Gas & Electric Company Value Delivery Surcredit Mechanism*	Case No. 2005-00352	12/2005
Kentucky Utilities Company Value Delivery Surcredit Mechanism*	Case No. 2005-00351	12/2005
Kentucky Power Company Electric Base Rate Proceeding*	Case No. 2005-00341	01/2006
Cumberland Valley Electric Cooperative Electric Base Rate Proceeding	Case No. 2005-00187	05/2006
South Kentucky Rural Electric Cooperative Electric Base Rate Proceeding	Case No. 2005-00450	07/2006
Duke Energy Kentucky Electric Base Rate Proceeding*	Case No. 2006-00172	09/2006
Atmos Energy Corporation Gas Show Cause Proceeding*	Case No. 2005-00057	09/2006
Inter County Electric Cooperative Electric Base Rate Proceeding	Case No. 2006-00415	04/2007
Atmos Energy Corporation Gas Base Rate Proceeding*	Case No. 2006-00464	04/2007
Columbia Gas of Kentucky Gas Base Rate Proceeding*	Case No. 2007-00008	06/2007
Delta Natural Gas Company Gas Base Rate Proceeding – Alternative Rate Mechanism*	Case No. 2007-00089	08/2007
Nolin Rural Electric Cooperative Corporation Electric Rate Proceeding	Case No. 2006-00466	09/2007
Fleming-Mason Energy Cooperative Electric Base Rate Proceeding	Case No. 2006-00022	10/2007

Jasckson Energy Cooperative Electric Base Rate Proceeding	Case No. 2007-00333	03/2008
Jackson Purchase Energy Corporation Electric Base Rate Proceeding	Case No. 2007-00116	04/2008
Blue Grass Energy Cooperative Electric Base Rate Proceeding	Case No. 2008-00011	7/2008
Louisville Gas & Electric Company Electric and Gas Base Rate Proceedings*	Case No. 2008-00252	10/2008
Kentucky Utilities Company Electric Base Rate Proceeding*	Case No. 2008-00251	10/2008
Owen Electric Cooperative Corporation Electric Base Rate Proceeding	Case No. 2008-00154	12/2008
Kenergy Corporation Electric Base Rate Proceeding	Case No. 2008-00323	12/2008
Kentucky-American Water Company Water Base Rate Proceeding*	Case No. 2008-00427	04/2009
Grayson Rural Electric Cooperative Electric Base Rate Proceeding	Case No. 2008-00254	04/2009
Farmers Rural Electric Cooperative Electric Base Rate Proceeding	Case No. 2008-00030	04/2009
Big Sandy Electric Cooperative Electric Base Rate Proceeding	Case No. 2008-oo401	04/2009
Columbia Gas Company Gas Base Rate Proceeding*	Case No. 2009-00141	09/2009
Duke Energy Kentucky Gas Base Rate Proceeding*	Case No. 2009-00202	10/2009
Licking Valley Rural Electric Cooperative Electric Base Rate Proceeding	Case No. 2009-00016	10/2009
Atmos Energy – Kentucky Electric Base Rate Proceeding	Case No. 2009-00354	03/2010

MAINE

Continental Telephone Company of Maine Base Rate Proceeding	Docket 90-040	12/1990
Central Maine Power Company Electric Base Rate Proceeding	Docket 90-076	03/1991
New England Telephone Corporation - Maine Chapter 120 Earnings Review	Docket 94-254	12/1994

MARYLAND

Potomac Electric Power Company Electric Base Rate Proceeding*	Case 7384	01/1980
Delmarva Power and Light Company Electric Base Rate Proceeding*	Case 7427	08/1980
Chesapeake and Potomac Telephone Company Western Electric and License Contract	Case 7467	10/1980
Chesapeake and Potomac Telephone Company Base Rate Proceeding*	Case 7467	10/1980
Washington Gas Light Company Gas Base Rate Proceeding	Case 7466	11/1980
Delmarva Power and Light Company Electric Base Rate Proceeding*	Case 7570	10/1981
Chesapeake and Potomac Telephone Company Base Rate Proceeding*	Case 7591	12/1981
Chesapeake and Potomac Telephone Company Base Rate Proceeding*	Case 7661	11/1982
Chesapeake and Potomac Telephone Company Computer Inquiry II*	Case 7661	12/1982
Chesapeake and Potomac Telephone Company Divestiture Base Rate Proceeding*	Case 7735	10/1983
AT&T Communications of Maryland	Case 7788	1984

Base Rate Proceeding		
Chesapeake and Potomac Telephone Company Base Rate Proceeding*	Case 7851	03/1985
Potomac Electric Power Company Electric Base Rate Proceeding	Case 7878	1985
Delmarva Power and Light Company Electric Base Rate Proceeding	Case 7829	1985

NEW HAMPSHIRE

Granite State Electric Company Electric Base Rate Proceeding	Docket DR 77-63	1977

NEW JERSEY

Elizabethtown Water Company Water Base Rate Proceeding	Docket 757-769	07/1975
Jersey Central Power and Light Company Electric Base Rate Proceeding	Docket 759-899	09/1975
Middlesex Water Company Water Base Rate Proceeding	Docket 761-37	01/1976
Jersey Central Power and Light Company Electric Base Rate Proceeding	Docket 769-965	09/1976
Public Service Electric and Gas Company Electric and Gas Base Rate Proceedings	Docket 761-8	10/1976
Atlantic City Electric Company Electric Base Rate Proceeding*	Docket 772-113	04/1977
Public Service Electric and Gas Company Electric and Gas Base Rate Proceedings*	Docket 7711-1107	05/1978
Public Service Electric and Gas Company Raw Materials Adjustment Clause	Docket 794-310	04/1979
Rockland Electric Company Electric Base Rate Proceeding*	Docket 795-413	09/1979

New Jersey Bell Telephone Company Base Rate Proceeding	Docket 802-135	02/1980
Rockland Electric Company Electric Fuel Clause Proceeding*	Docket 8011-836	02/1981
Rockland Electric Company Electric Base Rate Proceeding*	Docket 811-6	05/1981
Rockland Electric Company Electric Fuel Clause Proceeding*	Docket 8110-883	02/1982
Public Service Electric and Gas Company Electric Fuel Clause Proceeding*	Docket 812-76	08/1982
Public Service Electric and Gas Company Raw Materials Adjustment Clause	Docket 812-76	08/1982
New Jersey Bell Telephone Company Base Rate Proceeding	Docket 8211-1030	11/1982
Rockland Electric Company Electric Fuel Clause Proceeding*	Docket 829-777	12/1982
Public Service Electric and Gas Company Electric and Gas Base Rate Proceedings*	Docket 837-620	10/1983
New Jersey Bell Telephone Company Base Rate Proceeding	Docket 8311-954	11/1983
AT&T Communications of New Jersey Base Rate Proceeding*	Docket 8311-1035	02/1984
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Rockland Electric Company Electric Fuel Clause Proceeding	Docket ER9109145J	11/1991
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New Jersey Natural Gas Company Gas Base Rate Proceeding*	Docket GR9108-1393J	03/1992
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Rockland Electric Company Electric Fuel Clause Proceeding	Docket ER92090900J	12/1992
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Gas Base Rate Proceeding*		
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Borough of Butler Electric Utility Various Electric Fuel Clause Proceedings	Docket ER94020025	1994
Elizabethtown Water Company Water Base Rate Proceeding	Non-Docketed	11/1994
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Rockland Electric Company Electric Fuel Clause Proceeding and Purchased Power Contract By-Out	Docket Nos. 940200045 and ER 9409036	12/1994
Jersey Central Power & Light Company Electric Fuel Clause Proceeding	Docket ER94120577	05/1995
Elizabethtown Water Company Purchased Water Adjustment Clause Proceeding*	Docket WR95010010	05/1995
Middlesex Water Company Purchased Water Adjustment Clause Proceeding	Docket WR94020067	05/1995
New Jersey American Water Company* Base Rate Proceeding	Docket WR95040165	01/1996
Rockland Electric Company Electric Fuel Clause Proceeding	Docket ER95090425	01/1996
United Water of New Jersey Base Rate Proceeding*	Docket WR95070303	01/1996
Elizabethtown Water Company Base Rate Proceeding*	Docket WR95110557	03/1996
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United Water Vernon Sewage Company Base Rate Proceeding*	Docket WR96030204	07/1996
United Water Great Gorge Company	Docket WR96030205	07/1996

Base Rate Proceeding*		
South Jersey Gas Company Base Rate Proceeding	Docket GR960100932	08/1996
Middlesex Water Company Purchased Water Adjustment Clause Proceeding*	Docket WR96040307	08/1996
Atlantic City Electric Company Fuel Adjustment Clause Proceeding*	Docket No.ER96030257	08/1996
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Rockland Electric Company Electric Fuel Clause Proceeding*	Docket No.EC96110784	01/1997
Consumers New Jersey Water Company Base Rate Proceeding*	Docket No.WR96100768	03/1997
Atlantic City Electric Company Fuel Adjustment Clause Proceeding*	Docket No.ER97020105	08/1997
Public Service Electric & Gas Company Electric Restructuring Proceedings*	Docket Nos. EX912058Y, EO97070461, EO97070462, EO97070463	11/1997
Atlantic City Electric Company Limited Issue Rate Proceeding*	Docket No.ER97080562	12/1997
Rockland Electric Company Limited Issue Rate Proceeding	Docket No.ER97080567	12/1997
South Jersey Gas Company Limited Issue Rate Proceeding	Docket No.GR97050349	12/1997
New Jersey American Water Company Limited Issue Rate Proceeding	Docket No.WR97070538	12/1997
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Consumers New Jersey Water Company Base Rate Proceeding*	Docket No. WR97080615	01/1998
New Jersey-American Water Company Base Rate Proceeding*	Docket No.WR98010015	07/1998
Consumers New Jersey Water Company Merger Proceeding	Docket No.WM98080706	12/1998
Atlantic City Electric Company Fuel Adjustment Clause Proceeding*	Docket No.ER98090789	02/1999
Middlesex Water Company Base Rate Proceeding*	Docket No.WR98090795	03/1999
Mount Holly Water Company Base Rate Proceeding - Phase I*	Docket No. WR99010032	07/1999
Mount Holly Water Company Base Rate Proceeding - Phase II*	Docket No. WR99010032	09/1999
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Mount Holly Water Company Merger with Homestead Water Utility	Docket No. WM99020091	10/1999
Applied Wastewater Management, Inc. Merger with Homestead Treatment Utility	Docket No.WM99020090	10/1999
Environmental Disposal Corporation (Sewer) Base Rate Proceeding*	Docket No.WR99040249	02/2000
Elizabethtown Gas Company Gas Cost Adjustment Clause Proceeding DSM Adjustment Clause Proceeding	 Docket No.GR99070509 Docket No. GR99070510	 03/2000 03/2000
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Jersey Central Power & Light Company NUG Contract Buydown	Docket No. EM99120958	04/2000
Shore Water Company Base Rate Proceeding	Docket No. WR99090678	05/2000
Shorelands Water Company Water Diversion Rights Acquisition	Docket No. WO00030183	05/2000
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United Water Resources, Inc. Merger with Suez-Lyonnaise	Docket No. WM99110853	06/2000
E'Town Corporation Merger with Thames, Ltd.	Docket No. WM99120923	08/2000
Consumers Water Company Water Base Rate Proceeding*	Docket No. WR00030174	09/2000
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DSM Adjustment Clause Proceeding	Docket No. GR00070471	10/2000
Trenton Water Works Water Base Rate Proceeding*	Docket No. WR00020096	10/2000
Middlesex Water Company Water Base Rate Proceeding*	Docket No. WR00060362	11/2000
New Jersey American Water Company Land Sale - Ocean City	Docket No. WM00060389	11/2000
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Pineland Wastewater Company Wastewater Base Rate Proceeding*	Docket No. WR00070455	12/2000

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Roxbury Water Company Water Base Rate Proceeding	Docket No. WR01010006	06/2001
SB Water Company Water Base Rate Proceeding	Docket No. WR01040232	06/2001
Pennsgrove Water Company Water Base Rate Proceeding*	Docket No. WR00120939	07/2001
Public Service Electric & Gas Company Gas Base Rate Proceeding* Direct Testimony	Docket No. GR01050328	08/2001
Public Service Electric & Gas Company Gas Base Rate Proceeding* Surrebuttal Testimony	Docket No. GR01050328	09/2001
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Middlesex Water Company Financing Proceeding	Docket No. WF01090574	12/2001
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Consumers New Jersey Water Company Stock Transfer/Change in Control Proceeding	Docket No. WF01080523	01/2002
Consumers New Jersey Water Company Water Base Rate Proceeding	Docket No. WR02030133	07/2002
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Borough of Haledon – Water Department Water Base Rate Proceeding*	Docket No. WR01080532	07/2002

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Public Service Electric & Gas Company Electric Base Rate Proceeding Direct Testimony*	Docket No. ER02050303	10/2002
United Water Lambertville Land Sale Proceeding	Docket No. WM02080520	11/2002
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United Water New Jersey Metering Contract With Affiliate	Docket No. WO02080536	12/2002
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Public Service Electric & Gas Company Minimum Pension Liability Proceeding	Docket No. EO02110853	12/2002
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Rockland Electric Company Electric Base Rate Proceeding Direct Testimony*	Docket No. ER02100724	01/2003
Public Service Electric & Gas Company Supplemental Direct Testimony*	Docket No. ER02050303	02/2003
Rockland Electric Company Electric Base Rate Proceeding Supplemental Direct Testimony*	Docket No. ER02100724	02/2003
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Rockland Electric Company	Docket No. EA02020098	06/2003

Audit of Competitive Services		
New Jersey Natural Gas Company Audit of Competitive Services	Docket No. GA02020100	06/2003
Public Service Electric & Gas Company Audit of Competitive Services	Docket No. EA02020097	06/2003
Mount Holly Water Company Water Base Rate Proceeding*	Docket No. WR03070509	12/2003
Elizabethtown Water Company Water Base Rate Proceeding*	Docket No. WR03070510	12/2003
New Jersey-American Water Company Water and Sewer Base Rate Proceeding*	Docket No. WR03070511	12/2003
Applied Wastewater Management, Inc. Water and Sewer Base Rate Proceeding*	Docket No. WR03030222	01/2004
Middlesex Water Company Water Base Rate Proceeding	Docket No. WR03110900	04/2004
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Rockland Electric Company Societal Benefit Charge Proceeding	Docket No. ET04040235	08/2004
Wildwood Water Utility Water Base Rate Proceeding - Interim Rates	Docket No. WR04070620	08/2004
United Water Toms River Litigation Cost Accounting Proceeding	Docket No. WF04070603	11/2004
Lake Valley Water Company Water Base Rate Proceeding	Docket No. WR04070722	12/2004
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Jersey Central Power and Light Company Various Land Sales Proceedings	Docket No. EM04101107 Docket No. EM04101073	02/2005 02/2005

	Docket No. EM04111473	03/2005
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Rockland Electric Company Societal Benefit Charge Proceeding	Docket No. ET05040313	08/2005
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Aqua New Jersey Acquisition of Berkeley Water Co. Water Merger Proceeding	Docket No. WM04121767	08/2005
Middlesex Water Company Water Base Rate Proceeding	Docket No. WR05050451	10/2005
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Public Service Electric & Gas Company Merger of PSEG and Exelon Corporation Direct Testimony	Docket No. EM05020106	11/2005
Public Service Electric & Gas Company* Merger of PSEG and Exelon Corporation Surrebuttal Testimony	Docket No. EM05020106	12/2005
Public Service Electric & Gas Company* Financial Review of Electric Operations	Docket No. ER02050303	12/2005
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Roxiticus Water Company Stock Sale and Change of Ownership and Control	Docket No. WM05080755	01/2006
Public Service Electric & Gas Company Competitive Services Audit	Docket No. EA02020097	02/2006

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Pinelands Water Company Water Base Rate Proceeding*	Docket No. WR05080681	03/2006
Pinelands Wastewater Company Wastewater Base Rate Proceeding*	Docket No. WR05080680	03/2006
Aqua New Jersey Water Company Water Base Rate Proceeding*	Docket No. WR05121022	06/2006
Public Service Electric & Gas Company Gas Base Rate Proceeding*	Docket No. GR05100845	07/2006
New Jersey American Company Consolidated Water Base Rate Proceeding,* New Jersey American Water Company, Elizabethtown Water Company, and Mount Holly Water Company	Docket No. WR06030257	10/2006
Roxiticus Water Company Water Base Rate Proceeding	Docket No. WR06120884	04/2007
United Water Company of New Jersey Change of Control Proceeding	Docket No. WM06110767	05/2007
United Water Company of New Jersey Water Base Rate Proceeding*	Docket No. WR07020135	09/2007
Middlesex Water Company Water Base Rate Proceeding	Docket No. WR07040275	09/2007
Maxim Wastewater Company Purchased Sewerage Treatment Adjustment Clause	Docket No. WR07080632	11/2007
Fayson Lake Water Company Financing Case	Docket No. WF07080593	12/2007
Atlantic City Electric Company Sales of Utility Properties	Docket No. EM07100800	12/2007
Atlantic City Sewerage Company Base Rate and Purchased Sewerage Treatment Clause Proceedings	Docket No. WR07110866	04/2008

SB Water Company Water Base Rate Proceeding	Docket No. WR07110840	04/2008
Aqua New Jersey Water Company Water Base Rate Proceeding	Docket No. WR07120955	06/2008
Environmental Disposal Corporation Water Base Rate Proceeding	Docket No. WR07090715	06/2008
Middlesex Water Company Financing Case	Docket No. WF08040213	07/2008
Aqua New Jersey Water Company Franchise Case	Docket No. WE08040230	07/2008
Aqua New Jersey Water Company Financing Case	Docket No. WF08040216	07/2008
New Jersey American Water Company Water Base Rate Proceeding*	Docket No. WR08010020	07/2008
United Water Toms River, Inc. Water Base Rate Proceeding	Docket No. WR08030139	08/2008
New Jersey American Water Company Purchased Water and Purchased Sewer Treatment Adjustment Clauses	Docket No. WR08050371	10/2008
Pinelands Water Company Water Base Rate Proceeding	Docket No. WR08040282	12/2008
Pinelands Wastewater Company Wastewater Base Rate Proceeding	Docket No. WR08040283	12/2008
Applied Wastewater Management, Inc. Wastewater Base Rate Proceeding	Docket No. WR08080550	03/2009
New Jersey-American Water Company Implementation of Distribution System Improvement Charge (DSIC)*	Docket No. WO08050358	04/2009
United Water New Jersey Water Base Rate Proceeding	Docket No. WR08090710	04/2009
United Water Arlington Hills Sewerage Company Wastewater Base Rate Proceeding	Docket No. WR08100929	04/2009

United Water West Milford Inc. Water Base Rate Proceeding	Docket No. WR08100928	04/2009
Middlesex Water Company Purchased Water Adjustment Clause	Docket No. WR09010036	05/2009
Atlantic City Sewerage Company Purchased Sewerage Treatment Adjustment Clause	Docket No. WR09030201	05/2009
Roxiticus Water Company Purchased Water Adjustment Clause	Docket No. WR09020156	05/2009
Lawrenceville Water Company Change of Control Proceeding	Docket No. WM08110984	06/2009
Roxbury Water Company Water Base Rate Proceeding	Docket No. WR09010090	07/2009
Fayson Lake Water Company Financing Proceeding	Docket No. WF09080660	10/2009
Elizabethtown Gas Gas Base Rate Proceeding*	Docket No. GR09030195	10/2009
Andover Utility Company Wastewater Base Rate Proceeding*	Docket No. WR09050413	11/2009
Public Service Electric & Gas Company Electric Base Rate Proceeding*	Docket No. GR09050422	11/2009
Environmental Disposal Corporation Financing Proceeding	Docket No. WR07090715	12/2009
New Jersey American Water Company Financing Proceeding	Docket No. WM09110877	01/2010
Middlesex Water Company Water Base Rate Proceeding	Docket No. WR09080666	02/2010
Shore Water Company Water Base Rate Proceeding	Docket No. WR09070575	02/2010
Rockland Electric Company Electric Base Rate Proceeding*	Docket No. ER09080668	03/2010

Lake Lenape Water Company Water Base Rate Proceeding	Docket No. WR09090766	04/2010
Atlantic City Electric Company Electric Base Rate Proceeding*	Docket No. ER09080664	04/2010
United Water Toms River Company Water Base Rate Proceeding	Docket No. WR09110934	4/30/10
South Jersey Gas Company Gas Base Rate Proceeding	Docket No. GR10010035	5/28/10

<u>NEW MEXICO</u>

Southwestern Public Service Company Electric Base Rate Proceeding*	Case 1957	11/1985
El Paso Electric Company Rate Moderation Plan	Case 2009	1986
El Paso Electric Company Electric Base Rate Proceeding	Case 2092	06/1987
Gas Company of New Mexico Gas Base Rate Proceeding*	Case 2147	03/1988
El Paso Electric Company Electric Base Rate Proceeding*	Case 2162	06/1988
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El Paso Electric Company Electric Base Rate Proceeding*	Case 2279	11/1989
Gas Company of New Mexico Gas Base Rate Proceeding*	Case 2307	04/1990
El Paso Electric Company Rate Moderation Plan*	Case 2222	04/1990
Generic Electric Fuel Clause - New Mexico Amendments to NMPSC Rule 550	Case 2360	02/1991
Southwestern Public Service Company	Case 2573	03/1994

Rate Reduction Proceeding		
El Paso Electric Company Base Rate Proceeding	Case 2722	02/1998

OHIO

Dayton Power and Light Company Electric Base Rate Proceeding	Case 76-823	1976

PENNSYLVANIA

Duquesne Light Company Electric Base Rate Proceeding*	R.I.D. No. R-821945	09/1982
AT&T Communications of Pennsylvania Base Rate Proceeding*	Docket P-830452	04/1984
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National Fuel Gas Distribution Company Gas Base Rate Proceeding*	Docket R-870719	12/1987

RHODE ISLAND

Blackstone Valley Electric Company Electric Base Rate Proceeding	Docket No. 1289	
Newport Electric Company Report on Emergency Relief		

VERMONT

Continental Telephone Company of Vermont Base Rate Proceeding	Docket No. 3986	
Green Mountain Power Corporation Electric Base Rate Proceeding	Docket No. 5695	01/1994
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Central Vermont Public Service Corp. Electric Base Rate Proceeding*	Docket No. 5724	05/1994
Green Mountain Power Corporation Electric Base Rate Proceeding*	Docket No. 5780	01/1995
Green Mountain Power Corporation Electric Base Rate Proceeding*	Docket No. 5857	01/1996

VIRGIN ISLANDS

Virgin Islands Telephone Corporation Base Rate Proceeding*	Docket 126	